Miller, Crystal

From: Nick Cammarota <ncammarota@cbia.org>
Sent: Monday, April 11, 2011 12:58 PM
To: !FHFA REG-COMMENTS

Subject: RIN 2590-AA41

April 11, 2011

VIA E-MAIL: RegComments@fhfa.gov

Alfred M. Pollard
General Counsel
Attention: Comments/RIN 2590-AA41
Federal Housing Finance Agency
1700 G Street, NW.
Washington, DC 20552

RE: RIN 2590-AA41

Dear Mr. Pollard:

The California Building Industry Association ("CBIA") appreciates the opportunity to provide comments on the Federal Housing Finance Agency ("FHFA") notice of proposed rulemaking on Private Transfer Fees, published in the Federal Register on February 8, 2011.

CBIA is comprised of approximately 3,200 businesses in California including general contractors, subcontractors, land developers, builders, architects, engineers, land planners, attorneys, real estate agents and brokers, lenders, environmental expert consultants, interior designers and many others. Together they are responsible for the financing, acquisition, entitlement, construction, marketing and customer service for over 70% of new homes in California.

We urge that the Proposed Rule be revised to adopt a "community benefits covenant" approach applicable to non-profit organizations that administer transfer fees. This approach would avoid unnecessary interference with the community benefits fees tool while taking actions to maintain the stability of the financial markets and protect taxpayers. Please see our detailed recommendation included in ***Exhibit "A"***.

I. Summary

The Proposed Rule appropriately restricts transfer fees that only benefit private third parties (*e.g.,* developers); however, the Proposed Rule would also have the effect of unnecessarily limiting the ability of homebuyers to purchase property in the community that best makes sense to them, if a homebuyer's preferred property is encumbered by a community benefit transfer fee covenant affected by the Proposed Rule. Moreover, the Proposed Rule, as drafted, would create problems through the use of vague definitions, terms that are inconsistent with the Federal tax code concerning non-profit organizations, and create delay, uncertainty, and transaction costs damaging to the home finance market. It is also noted that the Proposed Rule's restrictions would have the effect of disparately impacting low-income homebuyers and people of color, who disproportionately purchase homes with mortgages that involve Fannie Mae, Freddie Mac, and the Federal Home Loan Banks.

Among other things, as written, the Proposed Rule would:

- take away the right of homebuyers, as a practical matter, to pay for the resources and services they believe best serve them and their community through community benefits fees;
- functionally disallow the use of transfer fees to increase and maintain value in mortgaged property through support of activities that provide community-wide benefits (*e.g.*, parks and conservation lands) in addition to benefits conferred to those paying the fee;
- create substantial uncertainty for mortgage making entities and for homebuyers 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;
- 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 process; and
- result in FHFA and other Federal regulators interpreting the ambiguously written rules through informal guidance documents and legal opinions.

Finally, the Proposed Rule would functionally establish limitations on community benefit transfer fees, while failing to provide any qualitative or quantitative analysis to support its position. *See Chamber of Commerce of the United States v. SEC*, 433 F.3d 890, 899 (D.C. Cir. 2006) (requiring that an agency must provide for public review the most critical factual material that is used to support the agency's policy position); *see, also Penobscot Indian Nation v. United States Department of Housing and Urban Development*, 539 F.Supp.2d 40, 48-49 (D.C. Dist. 2008) (requiring disclosure of technical studies and data upon which the agency relies in a rulemaking context).

II. Recommendations

CBIA recommends that the Proposed Rule be revised to follow, in large measure, 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, so that the value of properties can be established accordingly and homebuyers can make informed decisions;
- Express statements in the transfer fee covenant that fees are not payable upon foreclosure or short sale, a measure that will protect the financial market, Fannie Mae, Freddie Mac, and taxpayers; and
- Clear exceptions from the Proposed Rule for community-benefit fees paid to certain categories of entities (*e.g.* nonprofit organizations including Internal Revenue Code ("IRC") section 501(c)(3) and 501(c)(4) entities and 528 community associations), to conform the Proposed Rule to longstanding Internal Revenue Service ("IRS") law, regulations, and regulatory interpretations.

These recommendations collectively would support a "community benefits covenant" test with respect to nonprofit organizations, rather than the "direct benefit" test established by the Proposed Rule. This approach would achieve the Proposed Rule's policy goals in an administratively workable manner and in a way that preserves the rights of homebuyers to purchase properties that makes sense to them. Please see ***Exhibit "A"***, which proposes specific revisions to the Proposed Rule.

III. Analysis

A. Background

Approximately 90% of all home mortgages are purchased or otherwise backed by the Regulated Entities. Therefore, by barring the Regulated Entities from dealing in mortgages on properties with transfer fee covenants, in the vast majority of cases, the guidance would have prevented such properties from being bought or sold. As a practical matter, the guidance would have stopped the use of the transfer fee funding mechanism and affected tens of millions of residents in condominiums, cooperatives, and master planned, common interest developments.

The proposed guidance generated over 4,210 (mostly negative) comments, including comments that pointed out that proceeding by guidance rather than by rulemaking violated the Administrative Procedure Act and that compliance with the National Environmental Policy Act ("NEPA") was required. NEPA, 42 U.S.C. §§ 4321, *et seq*.

The Proposed Rule attempts to narrow the scope of the draft guidance, but creates new problems caused by the use of open-ended language, inconsistent terms, and continued improper functional limitations on the ability of individuals to make decisions about the purchase of their homes. The Proposed Rule principally departs from the guidance by (1) excepting transfer fees imposed prior to the date of the publication of the Proposed Rule; and (2) attempting to except transfer fees that are limited to paying for facilities and services that exclusively and directly benefit the encumbered properties, so long as such facilities and services do not also benefit the public at large. .

The ambiguities and inconsistencies of the Proposed Rule, in addition to its unnecessarily broad language, defeat the Proposed Rule's stated purpose -- to maintain the stability of the housing finance market -- 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 § 1228.2 (emphasis added). 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 § 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);
- Non-profit entities, homeowner associations and like organizations, when the transfer fees also benefit members of the public generally; and
- Non-profit entities, homeowner's associations and like organizations, when the transfer fees provide benefits to property or facilities (even if owned by the entity) located more than 1000 yards from the property burdened by the covenant.

The Proposed Rule explains its policy rationale against transfer fees in the preamble to the proposed regulations. With respect to private third parties the preamble states, "there is no relationship between the transfer fee and the actual cost to the developer." 76 Fed. Reg. 6706. Therefore, the preamble argues, 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 preamble 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.* Following this line of reasoning, the Proposed Rule exempts private transfer fees covenants only if they are used "exclusively for the direct benefit" of the property encumbered by the covenant. *See* Proposed Rule § 1228.1. Consequently, under the Proposed Rule's language the Regulated Entities are prohibited from dealing in mortgages encumbered with transfer fees that benefit the public, unless the benefited public pays a fee for the service or resource, regardless of whether the use of the transfer fee also enhances the value of the encumbered community.

Again, noting the ambiguity of the Proposed Rule, the following is a summary of the Proposed Rule's effect on different categories of transfer fees.[1]

Transfer Fee Category	**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)			• Developer-oriented type Transfer Fees
Mandatory Membership Residential Organization or Organization (*e.g.*, Homeowner's, Condominium, or Co-op Associations) or nonprofit organizations incorporated under IRS section 501(c)(3) or 501(c)(4)	• Maintenance of cooperative/ homeowner's 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, trails and parks
Federal/State/	Excluded from proposed		

Local Entities	rule		

C. The Proposed Rule Should be Clarified to Except Non-profit Organizations from the "Direct Benefits" Requirement to Avoid Inconsistency with Other Federal Law and Resolve Ambiguous Terms in the Proposed Rule's Language.

The Proposed Rule provides exceptions to its general prohibition on the Regulated Entities' ability to deal in mortgages on properties encumbered by private transfer fee covenants created after February 8, 2011; however, the language of the Proposed Rule includes ambiguities and internal contradictions that defeat its purpose. Specifically, the Proposed Rule appropriately defines IRC section 501(c)(3) and 501(c)(4) (charitable and community service) non-profit entities as "covered organization" eligible, in theory, to receive transfer fees under an excepted fee covenant.[2] Reinforcing the Proposed Rule's intention, the draft regulation also establishes "charitable use" as a permitted use of transfer fees. In practice, however, a non-profit entity exempt under IRC section 501(c)(3) and 501(c)(4) could never accept transfer fees that meet the proposed "direct benefits" requirement of the Proposed Rule, as the direct benefit requirement is fundamentally incompatible with IRC restrictions on charitable uses of funds, and characteristics of such charitable and public service nonprofit organizations. *See* Proposed Rule § 1228.1. This incompatibility results because charitable and public service nonprofit organizations are required to bestow benefit on the public, and not private interests. There is simply no such thing under federal tax law as a “charitable use” that “exclusively benefits” a private interest. The result is that charitable and community service entities could not administer transfer fees under the Proposed Rule, and charitable uses of transfer fees would be effectively banned, not withstanding the express intent to allow such uses.

This language conflict can be eliminated by excepting the use of transfer fees by nonprofit organizations, including IRC section 501(c)(3), 501(c)(4), and 528 entities from the proposed rule's "direct benefit" restrictions. This clarification would allow the practice to continue of charitable and community service entities administering trails, open space, recreation and transportation services through the use of community benefits transfer fees. The result caused by the conflicting definitions within the Proposed Rule is detailed below.

1. The Internal Revenue Code requires section 501(c)(3), 501(c)(4) and section 528 organizations to provide charitable and community benefits, respectively, and the United States Internal Revenue Service (IRS) will revoke such an organization's non-profit status if it serves a private purpose.

Federal tax code requires nonprofit organizations to engage in charitable and public purposes, and the IRS will revoke such an organization's nonprofit status if the IRS determines that the non-profit entity is being operated for private benefit.[3] With respect to IRC section 501(c)(3) organizations, IRS regulations require charitable entities to provide public benefits. *See* 26 CFR §1.501(c)-(1)(d)(ii). The Internal Revenue Service has considered whether 501(c)(3) nonprofits organizations can provide benefits *exclusively* to community associations, and it has concluded that they may not. The situation considered by the IRS was whether a block association established to preserve and beautify the immediate vicinity of block residents could qualify as a IRC section 501(c)(3) organization. Because the block association's purpose was found to serve private interests (*i.e.,* improving conditions for the block residents), the IRS determined that 501(c)(3) status was inappropriate. Rev. Rul. 75-286, 1975-2 C.B. 210.

Using the same reasoning, the IRS subsequently differentiated the block association scenario from that of an organization created to clean up a large lake and to provide recreational opportunities. In that case, the IRS determined that the benefits from the lake association flowed "principally to the general public through the maintenance and improvement of public recreational facilities,[and the benefit to lake-front residents was incidental only.]" Rev. Rul. 70-186, 1970-1 C.B. 128. Therefore, unlike the block association, which covered a

smaller geographical area and conferred primarily private benefits, the lake association provided primarily public benefits and qualified as an IRC section 501(3) organization.

Similarly, entities organized under IRC section 501(c)(4) must primarily provide benefits to the "community," rather than private individuals. Interpreting what constitutes a "community," the IRS determined that a "[community] 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. A community is not the same as a private development, and, in most situations, 501(c)(4) organizations must serve a broader area. In 2009, for example, the IRS issued a letter ruling rejecting 501(c)(4) status for a homeowner association that limited access to social activities and security patrol to its members. The IRS found that because the homeowner's association did not constitute a "community," 501(c)(4) status was not appropriate. Letter Ruling 20080935; *see also* Letter Ruling 200910067.

With respect to IRC section 528 organizations, the IRS will find that an entity qualifies if, among other things:

- it is organized and operated to provide for the acquisition, construction, management, maintenance, and care of association property;
- no part of the net earnings of the association inures to any private shareholder or individual;
- 90 percent or more of the association's expenditures for the taxable year are expenditures for the acquisition, construction, management, maintenance, and care of association property.

IRC § 528.

Therefore, as with IRC section 501(c)(3) and 501(c)(4) organizations, section 528 entities are not capable of creating revenues for the developer or using the funds other than for actions that support public policy goals.

2. The Proposed Rule requires that the "encumbered property" must receive the "exclusive" and "direct benefit" of the transfer fee, making it impossible for a 501(c)(3) or 501(c)(4) organizations to administer funds from newly established transfer fee covenants or for such funds to be applied to a "charitable" use, in contravention of existing statutes and the Proposed Rule's stated intent.

The Proposed Rule requires the transfer fees be used in a way that confers exclusively private benefits and, therefore, precludes charitable uses or administration of transfer fees by IRC section 501(c)(3) or 501(c)(4) organizations. Specifically, the Proposed Rule defines the term, "direct benefit," based on the type of activities to which funds are applied, the specific properties that are benefited, and the exclusivity of the benefits to the encumbered properties. Because the Proposed Rule limits the use of transfer fees to those which convey "direct benefits" to the encumbered property, the fees are inherently private in nature. Therefore, no IRC section 501(c)(3) or 501(c)(4) organization may use such transfer fees. The following reviews the definitions leading to the inconsistency.

i. Range of permissible activities under the Proposed Rule includes "charitable uses."

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, charitable, recreational, environmental, conservation or other similar activities…" Proposed Rule § 1228.1.

ii. The transfer fee must exclusively benefit the encumbered property, and no public benefit may flow from the transfer fee, 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."[4] Proposed Rule § 1228.1. The Proposed Rule further 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, under the Proposed Rule, educational facilities, conservation areas, and parks, for example, 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.

3. Excepting nonprofit entities from application of the "direct benefits" test would avoid internal contradiction within the Proposed Rule and harmonize its language with Federal statutes establishing the organization and purposes of non-profit organizations.

As discussed above, the direct benefit rule would prospectively, categorically exclude all IRC section 501(c)(3) and all but a few 501(c)(4) organizations from administering private transfer fee funds. It would also preclude charitable (*e.g.,* public benefit) uses of transfer fees. In addition, the direct benefits requirement would exclude homeowner associations and like organizations that use transfer fees in association with amenities, *e.g.*, parks or open space areas that are not restricted from public use. This conflict must be assumed to be inadvertent, as the Proposed Rule expressly calls out these organizations and charitable use as acceptable. This provision of the Proposed Rule requires revision to avoid the statutory conflict and an illogical result.

As detailed in ***Exhibit "A"***, CBIA recommends clearly exempting from the Proposed Rule community benefit transfer fees paid to certain categories of entities (*e.g.* nonprofit organizations including IRC section 528 community associations). This modification would harmonize the Proposed Rule's support for charitable use of transfer fees and allow for administration of transfer fee funds by nonprofit entities.

D. The Proposed Rule's Direct Benefit Requirement Should Not Apply to Transfer Fee Covenants that are: (1) Recorded; (2) Administered by a Non-profit Organization; and (3) Not Applicable in the Event of Judicial (or non-judicial) Foreclosure or Short Sale.

The Proposed Rule should avoid deciding for the homebuyer whether a transfer fee covenant should be included on a property backed by a Regulated Entity, provided the covenant meets the below criteria. We believe that the Proposed Rule should strengthen and simplify transactions rather than complicate them. Therefore, we recommend that the direct benefit test not apply, provided the transfer fee covenant is:

- recorded and fully disclosed;
- administered by an entity that acts in the public interest (*i.e.*, has Federal non-profit status); and
- inapplicable in the event of judicial or non-judicial foreclosure or short sale.

These criteria (collectively, "community benefits covenants") protect the collateral value of properties subject to transfer fee covenants by placing the transfer fee covenant information in the hands of the homebuyer and mortgage making entities so that a reasoned decision can be made -- one that results in an appropriate price and terms and conditions of any sale and loan. In addition, these criteria substantively assure that no transfer fee will be paid to a private profit seeking third party.

This approach to the regulation of transfer fees is more protective of the public than the strategies employed by many states. Moreover, it is workable, in that it is internally consistent, externally consistent with other law and

administratively feasible. At the same time, it establishes clear and consistent parameters within which individuals are free to negotiate and purchase homes at the price and on the terms that make sense to them.

1. Requiring that transfer fee covenants be recorded provides the homebuyer with the information needed to decide whether the transfer fee covenant is appropriate in light of price, terms and the many other factors that go into the decision to purchase a home.

Requiring transfer fee covenants to be recorded would ensure that notice is given to homebuyers of the obligations associated with the property. In large measure (and with special notice requirements), California has adopted this approach. *See* Cal. Civ. Code §§ 1098, et seq. California recognizes that the homebuyer is capable -- with all information disclosed -- of determining whether a transfer fee covenant makes sense in light of the negotiated price of the property, the terms and conditions of the agreement, and the many other factors that go into the decision to purchase a home.

This "freedom to contract" approach to servitudes is also, in large measure, the approach adopted by the American Law Institute in the Restatement (Third) of Property, Servitudes ("Restatement").[5] The Restatement's adoption of the freedom to contract approach to servitudes is broad. The Restatement provides:

> If such [servitude] arrangements are not unconscionable and do not otherwise violate public policy, there is usually no reason to deny the parties freedom to 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
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> [C]ourts should not attempt to weigh the harm caused by an indirect restraint against the overall value of the transaction in which the servitude played a part. There are too many potential variables, and private decisionmaking is more likely than judicial to increase overall wealth and well-being.

Restatement (Third) of Prop.: Servitudes, § 3.5 cmt. A (2000).[6] Indeed, with respect to transfer fees, the Restatement provides, "these arrangements are not invalid if there is some rational justification for requiring the grantee to share the proceeds with another." Restatement, 3.5.c We question whether a rational justification meeting the Restatement standard would exist in situations where fees are paid to the developer. On the other hand, there is rational justification for community benefit fees, and we are confident that properly drafted and recorded community benefit fees can meet the traditional common law requirements or the Restatement requirements, and would be permitted. [7]

2. Requiring that community benefits be administered by an IRS status 501(c)(3), 501(c)(4) or 528 organization would ensure that the fees are applied to purposes that serve public policy goals and do not inure to private parties.

As described above, the IRS only grants nonprofit status to entities that meet public policy goals. Therefore, provided that a nonprofit organization is administering the transfer fees, the purpose to which those fees are applied will be legitimate and in the public interest, rather than inuring to the benefit of a private third party. Section 528 organizations also are not capable of creating revenues for the developer or using funds for actions other than those that support community-benefits goals.

3. Requiring that transfer fee covenants not mandate the payment of a fee upon transfer resulting from foreclosure or short sale would further limit the financial exposure to the Regulated Entities.

Requiring that transfer fee covenants do not result in the assessment of a fee upon short sale, foreclosure or similar event (*e.g.*, deed in lieu of foreclosure) would further protect the stability of financial markets. Moreover, such a requirement would also protect the Regulated Entities and taxpayers in the event of foreclosure or short sale.

4. Revision Summary

Therefore, under the proposed revisions, collateral value would be assured through appropriate disclosure provided by recording requirements, developers would not have access to the transfer fees and funds will be applied to uses that support public policy, and in the event of foreclosure or short sale no fee would be assessed. These "community benefits covenants" would allow for appropriate community-benefit uses, while avoiding the adverse consequences of some private transfer fee covenants that the Proposed Rule intended to address.

E. The Proposed Rule Would Create Unintended Consequences Measured in Terms of Uncertainty, Cost, and Delay to the Housing Finance Market, Impacting Homebuyers, Market Participants, and Developers.

The "direct benefits" rule would impose substantial transaction costs on the purchase and sale of homes and would substantially interfere with the stability of the housing finance market. Under the Proposed Rule, when a property subject to a transfer fee covenant is sold, the Regulated Entities-- and most likely, a loan officer at a member bank-- will be required to examine the transfer fee covenant to determine whether the covenant is an "excepted transfer fee covenant" or is otherwise excluded from the Proposed Rule's requirements. This determination must include an analysis of the following, among others:

- Date the transfer fee was first imposed, and if after the date of the Proposed Rule, the following:
- Status of the entity receiving or using the fees generated by the transfer fee (*i.e.,* whether the entity is a covered association, within the meaning of the Proposed Rule;
- Purpose to which the transfer fees will be applied;
- Distance between the encumbered property and the location of any facility at which the transfer fee could be used;
- Distance from the "community of transfer fee encumbered properties" from the location where the transfer fee is located;
- Whether the transfer fees are used to fund facilities that are open to the general public, and if so, whether members of the public required to pay a fee;
- Whether any use by a nonprofit entity of a facility funded by transfer fees is, in fact, *de minimis*.

These fact-based determinations are in addition to the myriad policy-based determinations that the loan officer will be required to make, such as, whether shuttle transportation service that extends beyond 1000 yards (*e.g.*, to a supermarket) is outside the bounds of what is allowed, whether affordable housing subsidized by transfer fees and located proximate to the community provides a direct benefit to the community, and similar inquiries.

These determinations, in many cases, will require in-the-field determinations and policy-based interpretations of the Proposed Rule. Loan application costs and processing times will increase as a result of the Proposed Rule, creating a deadweight loss on the home finance market, homebuyers, and others that will eclipse any conceivable gain.

Moreover, issues of consistency and accuracy of the loan officers' determinations would also be implicated under the Proposed Rule. These include the honest mistakes that are likely to arise in fact-based determinations and discrepancies between policy interpretation between loan officers and finance institutions. The issues will

create a loss of predictability and stability in the finance market. Particularly pernicious, because people of color and low-income homebuyers disproportionately rely on the loans backed by the Regulated Entities, these costs and uncertainties will have a disparate effect, raising civil rights questions.

Further, these transaction costs and uncertainties will alter the behavior of developers and prospective homebuyers, distorting the finance market on the demand side, and on the supply side, creating disincentives for lenders to consider loans against properties encumbered by transfer fee covenants. As distinguished law professor Richard Epstein identified roughly 30 years ago with respect to application of the "touch and concern doctrine,"

> When the status of a servitude is uncertain, the touch and concern requirement merely introduces an additional transactional barrier to subsequent transfers of real estate. For example, the purchaser of a dominant estate may refuse to go forward because his fastidious lawyer tells him that title is not marketable. Should we expect parties to entertain a lawsuit to establish the validity of a servitude before a sale takes place or to negotiate with the holders of servient tenements to eliminate residual uncertainty? These things can be done, but only with high transaction costs.

See Richard Epstein, Notice and Freedom of Contract in the Law of Servitudes, 55 S. Cal. L. Rev 1353, 1359 (1982).

The requirements established under the Proposed Rule create just this type of uncertainty. It is noted, as well, that this uncertainty will be experienced both at the time of purchase and sale, and, potentially more acutely, at time of real estate project development. This is due to the developer being ultimately dependent on the homebuyers ability to access the home finance market, which is dominated by the Regulated Entities, which would be subject to the Proposed Rule. In other words, given the foreseeable confusion that will be created by the Proposed Rule, developers will be at risk of producing housing projects that cannot be sold/purchased if, for example, transfer fee covenants are established to fund cultural, educational, charitable, recreational, environmental, conservation or other similar activities, and then later deemed restricted by mortgage makers under the Proposed Rule.

F. No Analytical Support Is Provided for the Proposed Rule's Limitations on the Regulated Entities' Ability to Deal in Mortgages on Properties with Private Transfer Fee Covenants that Fund IRC 501(c)(3), 501(c)(4) or 528 Organization.

An agency must provide the evidentiary basis for its regulations both so that the public may have a meaningful opportunity to comment and so that a reviewing court may discern the rationale for the agency’s action. *See Chamber of Commerce of the United States v. SEC*, 433 F.3d 890, 899 (DC Cir. 2006). Here, the preamble to Proposed Rule has articulated the opinion that a broad variety of transfer fees adversely affects the stability of the housing financial markets, without establishing any factual basis for that opinion with respect to transfer fee covenants payable to IRC section 501(c)(3), 501(c)(4) or 528 organizations. Rather than identifying specific problems or even potential future problems based on any factual research or analysis associated with community benefits fees, the Proposed Rule proposes to end the long-standing practice of transfer-fee supported community benefits. The Proposed Rule ignores the benefits associated with the covenants it would restrict. Although a formal cost-benefit analysis is not required, the Proposed Rule cannot wholly ignore the benefits associated with community benefits fees, including those identified in comments submitted in response to the former proposed guidance, nor can it ignore its costs.

Evidence provided in comments on the former proposed guidance, submitted by the Community Benefits Coalition and the Community Association Institute, demonstrates the prevalence and value of community

benefit fees with respect to properties encumbered by transfer fees. This evidence shows that community-benefits fees have more than a twenty-year track record and have not been shown to pose risks to the stability and liquidity of the housing finance market.

1. Despite more than two decades of experience and pervasive use of the community benefits fee mechanism there is no evidence that they contribute to financial instability or illiquidity of the housing finance market.

According to a September 2010 survey conducted by the Community Association Institute (the "CAI Survey"), transfer fee covenants have been in effect for more than a generation. *See CAI, Comment Letter No. 993, Attachment B, To: FHFA* (October 5, 2010). Indeed, of the 1,254 homeowner's associations responding to the CAI Survey, more than forty percent (40%) stated that the transfer fees provisions had been in place for more than ten (10) years. Additionally, the CAI Survey notes that the responding communities were located in forty (40) states across the country, demonstrating wide-spread use of transfer fees. This pervasive use, combined with the lack of any apparent disruption in financial markets caused by community-benefits fees, represents, perhaps, the strongest evidence that such transfer fees do not disrupt the housing finance market.

Moreover, community-benefits fees are used extensively across the country to create and maintain diverse, sustainable, livable communities, and to provide other amenities and important services. These are the communities in which homebuyers increasingly choose to live, and developers build these communities in response to market demand. In many cases, the resources necessary to support these communities would not exist but for the availability of the community-benefits fees, and the benefits associated with such community benefits covenants should be accounted under the Proposed Rule.

2. Community benefits fees that would not be permitted, or are at risk, under the Proposed Rule have been shown to add value to properties and communities, and the costs associated disallowing such funding mechanisms has not been considered.

The following are examples of recent projects that have used community-benefits fees to establish and maintain livable communities. These projects would have been at risk, or functionally not permitted, if subject to the Proposed Rule:

- **Affordable Housing:** In Teton County, Wyoming, the Snake River Sporting Club Development agreed with the County to establish a community-benefits fee devoted to affordable and workforce housing and to help ensure local public school teachers can afford to live in the communities in which they teach.
- **Environmental/Affordable Housing:** In Maine, the initial owner/developer and all subsequent homeowners of the Moosehead Lake Project will pay community-benefits fees to provide long-term support for affordable housing, public recreation, and wildlife preservation. Funds from this community-benefits fee will be distributed as follows: 45% toward support of community affordable housing to be directed by state agencies; 45% to support community recreation opportunities (*e.g.*, public boat launches and trails) to be distributed via a non-profit 501(c)(3) organization; and 10% to be distributed via state agencies to support wildlife programs.
- **Transit:** In Dublin, California, the Bay Area Rapid Transit District partnered with a private developer to establish a community-benefits fee that funds increased light rail service for a new, mixed income community and other local residents.
- **Environmental:** Transfer fee agreements have been used for preservation and restoration throughout California, including projects in the Martis Valley near Lake Tahoe, the Ballona wetlands in Playa Vista, and in the Central Valley in Placer County.
- **Conservation:** Dozens of land trusts across the United States use community-benefits fees to fund perpetual stewardship of voluntary conservation land. Landowners want to use these fees to ensure that

their gifts of conservation lands remain conserved for the public benefit. Low Country Land Trust in South Carolina, for example, holds over 160 such conservation easements. Additionally, the Golden State Land Conservancy in California, Jackson Hole Land Trust in Wyoming and the Columbia Land Conservancy in New York are examples of dozens of other land trusts that rely on community-benefits fees to ensure that their charitable missions are fulfilled.

Rather than impeding the sale of properties or creating new risks, evidence shows that community-benefits fees can maintain and enhance property values. For example, an Arizona-based study showed that the DC Ranch community, which has a community-benefits fee, maintains a higher sale price per square foot ($214.14) as compared to the adjacent communities of Grayhawk and McDowell Mountain Ranch ($196.08 and $185.17, respectively), which have no private transfer fees. Additionally, a 2009 survey by Robert Charles Lesser & Co. noted that at least five of the ten top selling master planned communities in Maricopa County, Arizona have transfer fee covenants.

3. Summary

Notwithstanding evidence and experience of CBIA members and others, the Proposed Rule and associated preamble do not address the benefits that community benefits can create, nor does it consider the costs the Proposed Rule would create through increased transaction costs, as described under section E, herein, or the loss of benefits generated by the community benefits funding mechanism.

IV. Conclusion

The Proposed Rule would unnecessarily restrict homebuyers' freedom to contract for the home of their choosing and imbeds new transaction cost delays in the home financing market. Because low-income homebuyers and people of color disproportionately purchase homes covered by the Regulated Entities, they will be disparately impacted, raising civil rights concerns. Additionally, due to the internally conflicting language of the Proposed Rule and inconsistencies with Federal law, nonprofit entities organized under IRC section 501(c)(3) or 501(c)(4) and some IRC section 528 organizations would functionally not be able to receive or use funds generated by new transfer fee covenants. These effects and others can be avoided by adoption of revisions suggested above and in ***Exhibit "A"*** that would except community benefits covenants from the regulation's general rule.

Thank you for considering the issues raised in these comments.

Sincerely,

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Exhibit "A"

Proposed Definitions Incorporating Community-Benefits Covenant Revisions

Bolded language indicates inserted or new text.

§ 1228.1 Definitions.

As used in this part,

Foreclosure means a transfer of property resulting from a foreclosure, whether judicial or non-judicial, or deed in lieu of foreclosure of a mortgage, deed of trust or other security interest made in good faith and for value.

Short sale means a transfer of property in which the lender has agreed to accept less than the outstanding balance of a mortgage, deed of trust or other security interest made in good faith and for value.

Nonprofit Organization means an entity described in section 501(c)(3), 501(c)(4) or 528 of the Internal Revenue Code ("IRC").

Qualified Use means an activity promoting: (i) charitable purposes, in the case of an entity organized under IRC section 501(c)(3); (ii) social welfare, in the case of an entity organized under IRC section 501(c)(4), or (iii) acquisition, construction, management, maintenance, and care of association property in the case of an entity organized under IRC section 528.

Excepted transfer fee covenant means **(i)** a **recorded** covenant to pay a private transfer fee to a covered association ~~that is~~**, which covenant provides that the transfer fee is to be** used exclusively for the direct benefit of the real property encumbered by the private transfer fee covenants**, or (ii) a recorded covenant to pay a private transfer fee to a Nonprofit Organization which covenant provides: (a) that the transfer fee is to be used for one or more expressly enumerated Qualified Use(s), and (b) that such fee is not payable upon a transfer resulting from a foreclosure or short sale.**

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[1] For an example of such ambiguities, 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."

2 The term, "covered association," includes typical homeowners/condominium or cooperative associations established under a declaration or covenant (i.e., organizations organized under IRC section 528), or other nonprofit entity organized under IRC section 501(c)(3) or 501(c)(4). Proposed Rule § 1228.1.

[3] This same restriction against inurnment of private benefit, as discussed below, also applies to IRC section 528 organizations.

[4] As noted in footnote 1 of this comment letter, there is inconsistency within the Proposed Rule as to whether the benefit from the use of the transfer fee must flow to the covenant encumbered property, as provided in the definition of "covered association," or as provided in the definition of "direct benefit," the "benefit 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]." *See* Proposed Rule Section 1228.1. 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 from the transfer fee are used to fund a clubhouse, for example, and an individual lot that would be subject to the transfer fee is not within 1000 yards of the clubhouse.

[5] The Restatement expressly states that the "touch-and-concern" doctrine is superseded, as applied to covenants. Restatement (Third) of Prop. Section 3; however, the Restatement includes substantive constraints on servitudes, including, e.g., that they not violate public policy, or be irrational, unconscionable or unlimited in duration.

[6] The Restatement also notes that, "[t]he average buyer may not appreciate the long-term significance of the servitude arrangement because the physical characteristics of the housing and the quality of the neighborhood are likely to occupy the forefront of the buyer's attention." Restatement, (Third) of Prop.: Servitudes, §3.7, cmt. C. In particular, the Restatement identifies that, "The servitudes imposing the obligation to pay may be unconscionable with respect to these obligations, particularly if the circumstances include self-dealing by the developer." *Id.* To address this situation, the Restatement tempers the pure "freedom-to-contract" approach by retaining the common law doctrine of "unconscionability," which would allow a court to modify or terminate the covenant, as warranted.
[7] Community-benefits fees are typically fashioned through a collaborative effort on the part of communities, elected officials, landowners, developers, and nonprofit organizations to achieve a variety of community-wide goals. The process though which community-benefits fees are fashioned, in addition to the negotiation that occurs during an individual sale, helps ensure the rational justification.

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The Voice of Housing in California
www.cbia.org

California Building Industry Association
California Homebuilding Foundation
PCBC Advancing The Art + Science of Community Building

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