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April 11, 2011

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

Re: RIN 2590-AA41 [FHFA Proposed Rule Restricting the Acquisition of, or Taking Security Interests in, Mortgages on Properties Encumbered by Certain Private Transfer Fee Covenants and Related Securities]

Dear Mr. Pollard:

Hyatt & Stubblefield, PC is a law firm comprised of real estate attorneys whose practice has focused almost exclusively on the creation and operation of condominiums and planned communities through the United States over the last 37 years. By letter dated September 29, 2010, we submitted comments on FHFA's proposed guidance regarding private transfer fee covenants. While we are generally pleased with FHFA's response to public comments as expressed in the Part IV.C. of the above-referenced rule (hereafter, "Proposed Rule"), we believe the actual language proposed to be codified at 12 C.F.R. Part 1228 requires some modification in order to appropriately reflect FHFA's expressed intent and avoid unintended consequences. The following discussion sets forth our specific comments and concerns and the attached blacklined draft of the Proposed Rule ("Proposed Revisions") reflects our recommended revisions to address these concerns.

1. Encumbered Property or Properties. Section 1228.1 of the Proposed Rule uses a variety of terms and phrases to refer to the real property encumbered by a private transfer fee covenant, including "the encumbered property," "the encumbered real property," "the encumbered properties," "the property," "such real property," "the community comprising the encumbered properties," and "the burdened community." The terms "encumbered property" and "encumbered properties" appear to be used interchangeably. To avoid ambiguity leading to unintended consequences, and to simplify other definitions, we would urge FHFA to include in the Proposed Rule the following two defined terms to clearly distinguish between (i) a particular lot or parcel encumbered by a transfer fee covenant and (ii) all of the properties in a community encumbered by the same transfer fee covenant, and to substitute these terms for the above references as indicated in the attached Proposed Revisions:

"*Burdened Community*" means the community comprised of all of the parcels or interests in real property encumbered by a single private transfer fee covenant or a series of separate private transfer fee covenants which require payment of private transfer fees to the same entity to be used for the same purposes.

"*Encumbered Property*" means a particular lot or interest in real property encumbered by a private transfer fee covenant, the transfer of which triggers the obligation to pay a private transfer fee.

2. Excepted Transfer Fee Covenants. Section 1228.1 of the Proposed Rule defines an "excepted transfer fee covenant" as "a covenant to pay a private transfer fee to a covered association *that is used* exclusively for the direct benefit of the real property encumbered by the private transfer fee covenants." [Emphasis added]. There are several issues with the wording of this definition:

(a) In order to incorporate the essential elements of a "private transfer fee covenant," as defined later in Section 1228.1, the phrase "a covenant to pay […]" should be revised to read, "a private transfer fee covenant which requires payment of […]";

(a) The phrase "*that is used*" requires a factual determination as to how the covered association is actually using the transfer fees. The Banks and Enterprises (as defined in the Proposed Rule) should not be required to look beyond the specific wording of the covenant to determine whether a particular covenant is an "excepted private transfer fee covenant." If required to investigate and make a factual determination, the Banks, Enterprises, and title insurers are likely to simply decline to deal with properties encumbered by *any* transfer fee covenant, whether or not it might fall within the definition of an "excepted transfer fee covenant," defeating the purpose and intent of this exception; and

(c) The requirement that the transfer fees be used exclusively for the direct benefit of "the real property encumbered by" the private transfer fee covenants could be construed to restrict use of the transfer fees to maintenance and improvement of the individual homes, lots or parcels encumbered by the covenant when, in practice, transfer fees are rarely if ever used for such purpose. Rather, they are typically used for things such as (i) the maintenance or improvement of common facilities, such as parks, trails, and recreational facilities owned, operated, or maintained by the association for the use of the owners and occupants of the encumbered property; and (ii) educational, cultural, recreational and social programs and activities which are sponsored by the association for the benefit of the owners and occupants of the burdened community.

By requiring that any "direct benefit" run exclusively to the encumbered property, the definition of an "excepted transfer fee covenant" is more restrictive than the term "direct benefit"

itself, which specifically contemplates, in the second sentence thereof, that the direct benefit might flow to the encumbered property, the burdened community and its common areas, and to adjacent or contiguous properties. It also overlooks the fact that covered associations often use transfer fees to provide programs and activities for the benefit of the *owners and occupants of* the burdened properties, rather than providing a direct benefit to the properties themselves.

We believe a more appropriate definition of "excepted transfer fee covenant" would incorporate the required elements of the defined term "private transfer fee covenant," would limit the inquiry to matters that can be determined from a reading of the covenant itself, and would allow the "direct benefit" to flow to the owners and occupants of the encumbered properties, to the burdened community (as defined earlier in this letter), or to any property adjacent or contiguous to the burdened community. We urge FHFA to make the following changes to the definition of "excepted transfer fee covenant," incorporating the new defined terms "encumbered property" and "burdened community" as suggested above, and making it consistent with the definition of "direct benefit":

> *Excepted transfer fee covenant* means a private transfer fee covenant ~~requiring~~which requires payment of ~~a~~ private transfer fees to a covered association ~~that is used exclusively for the~~ and limits the use of such transfer fees exclusively to purposes which provide a direct benefit ~~eal property encumbered by the private transfer fee covenant~~to the burdened community or the owners and occupants thereof, or to adjacent or contiguous property.

3. Direct Benefit. The first sentence of the definition of "Direct benefit" in Section 1228.1 states, "Direct benefit means that the proceeds of a private transfer fee are used exclusively to support maintenance and improvements to encumbered properties *as well as* cultural, educational, charitable, recreational, environmental, conservation or other similar activities that benefit exclusively the real property encumbered by the private transfer fee covenants […]." There are several problems with this language:

(a) As stated earlier, transfer fees are rarely if ever used to maintain and improve the individual properties encumbered by the transfer fee covenant, yet this appears to be mandated by the first clause of this definition. We urge FHFA to expand the list of permitted uses to include (i) the acquisition, improvement, maintenance, repair, or replacement of property owned, operated, or maintained by the covered association, other property within the burdened community, or property adjacent or contiguous to the burdened community, and (ii) programs and activities for the benefit of the owners and occupants of the burdened community;

(b) The use of the conjunctive phrase "*as well as*" can be read to mandate that the transfer fees be used not only for one or more of the listed purposes preceding such phrase but also for one or more of the listed purposes following such phrase. It should be sufficient that the fees are used for any one of the authorized purposes. The use of the fees for multiple purposes should not be required;

(c) By law, the activities of an organization described in I.R.C. Sections 501(c)(3) and 501(c)(4) must provide a public benefit, so they cannot "benefit *exclusively* the real property encumbered by the private transfer fee covenants," although they often provide a greater benefit to the encumbered properties than to the general public; and

(d) The owners of the encumbered properties, acting through a board or committee they select, should be permitted to direct the transfer fees to enhancement of local schools, libraries, or other public services (e.g., volunteer fire department) which benefit the burdened community, even if those schools, libraries or public services are not physically located within the burdened community or within 1000 feet of the burdened community.

In the second sentence of the definition of "direct benefit," the phrase "community *comprising* the encumbered properties" should be corrected to read, "community *comprised of* the encumbered properties"; however, with the changes recommended in Paragraphs 1 and 2 of this letter, the latter part of the first sentence and the entire second sentence of this definition (addressing the property to which the direct benefit must flow) could be deleted as shown in the attached proposed revisions, eliminating this problem.

The last sentence of the definition of "direct benefit" indicates that any public use of facilities funded by transfer fees must be subject to payment of use fees, except for *de minimis* usage by charitable or not-for-profit groups. This requirement overlooks the fact that, in many cases, the nature of the property or facilities being maintained by covered associations using transfer fees is such that charging a use fee is either impractical or inconsistent with the nature of the facility. For example, a covered association may use transfer fees to maintain parks or trails within the burdened community which are part of a larger network of parks and trails owned and maintained by other entities, with reciprocal use rights for their respective members or open to use by the general public. The owners of the encumbered properties would be entitled to use that part of the park or trail network lying outside of the burdened community in exchange for the covered association permitting others to use the parks and trails within the burdened community. Even where the parks or trails are not part of a larger network, it is often impractical to prevent public use of the association's parks and trails, as policing to prevent public use would be cost-prohibitive and there may be no single point of access at which public use fees could be collected. The fact that there may be incidental benefit to the general public does not detract from the benefits enjoys by the owners and occupants of the burdened community and should not be a factor in determining whether the direct benefit requirement is met.

Since the concept of "direct benefit" relates solely to the definition of "excepted transfer fee covenants," we believe that all of the above concerns could be addressed, and the Proposed Rule could be greatly simplified, by deleting the separate definition of "Direct benefit" in Section 1228.1 and adding the following language to the end of the revised definition of "Excepted transfer fee covenant" suggested above:

> *Activities which provide a direct benefit* to the burdened community shall be deemed to include, without limitation: acquisition, improvement, maintenance, repair, or replacement of property owned, operated, or maintained by the covered association, other property within the burdened community, or property adjacent or contiguous to the burdened community; or cultural, educational, charitable, social, recreational, environmental, conservation or other similar activities and programs conducted within the burdened community or undertaken to enhance local schools, libraries, or public services which serve the burdened community.

4. Adjacent or contiguous property. The definition of "adjacent or contiguous property" in Section 1228.1 is unnecessarily verbose and cumbersome in its use of the phrasing "the property 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." If, as recommended above, FHFA includes the term "burdened community" as a defined term in Section 1228.1, this entire quoted phrase could simply be replaced with "the burdened community."

The second clause of this definition, which reads, "*provided* that in no event shall a property greater than one thousand (1000) yards from the encumbered property be considered adjacent or contiguous" is problematic in that (a) it eliminates the ability of a covered association to maintain its office in a commercial area outside of the burdened community or use transfer fees to enhance local schools, libraries, fire departments, and similar public services which in turn benefit the burdened community; (b) it creates a standard which is difficult to apply to programs and activities; and (c) uses the term "encumbered property" rather than "encumbered properties" or "burdened community," which can be literally interpreted to prohibit the use of transfer fees collected on a particular lot to benefit property that is more than 1000 yards from that particular lot, even if the benefited property is within the overall burdened community.

These issues can be addressed by revising the definition to simply read as follows:

> *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~~burdened community.

5. Covered association. The phrase "organization comprising owners of" in this definition should be corrected to read, "organization *comprised of* owners of" (since the organization is comprised of owners, not the other way around).

6. Private transfer fee. The definition of "private transfer fee" should be revised to incorporate the concept that it is a fee that is payable on an ongoing basis each time the property transfers (except for any transfers specifically exempted by the terms of the covenant), and that the obligation arises pursuant to a covenant executed and recorded by someone other than the

owner of the encumbered property before the owner of the encumbered property took title. It should not include any fee, charge or amount payable on a one-time basis that the owner of the property contractually agreed to pay and which is simply memorialized in a memorandum of agreement, mortgage, or similar document recorded in the land records which, once satisfied, ceases to be an encumbrance on the property. This would eliminate the need to itemize, in addition to items (1) through (4), numerous other items that would otherwise need to be listed as exceptions in that definition.

6. Effective Date. We would urge FHFA to change the effective date of the Proposed Rule to the date that the Final Rules is announced, rather than the date that the Proposed Rule is announced, so that those who would be affected by the final Rule have notice of the full extent of its applicability prior to it taking effect.

Respectfully submitted,

Jo Anne P. Stubblefield

JPS:user

Attachment

PART 1228—RESTRICTIONS ON THE ACQUISITION OF, OR TAKING SECURITY INTERESTS IN, MORTGAGES ON PROPERTIES ENCUMBERED BY CERTAIN PRIVATE TRANSFER FEE COVENANTS AND RELATED SECURITIES

Sec.
1228.1 Definitions.
1228.2 Restrictions.
1228.3 Prospective application and effective date.
1228.4 State restrictions unaffected.

Authority: 12 U.S.C. 4513(a)(1)(B) and 12 U.S.C. 4526(a).

§ 1228.1 Definitions.

As used in this part,

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~~burdened community.

Burdened community means, collectively, all of the parcels of real property encumbered by a single private transfer fee covenant or a series of separate private transfer fee covenants which require payment of private transfer fees to the same covered association to be used for the same purposes.

Covered association means a nonprofit, mandatory membership organization comprising of owners of homes, condominiums, cooperatives, manufactured homes or any interest in real property, created pursuant to a declaration, covenant or other applicable law, or an organization described in section 501(c)(3) or (c)(4) of the Internal Revenue Code.

~~*Direct benefit* means that the proceeds of a private transfer fee are used exclusively to support maintenance and improvements to encumbered properties as well as cultural, educational, charitable, recreational, environmental, conservation or other similar activities that benefit exclusively the real property encumbered by the private transfer fee covenants. Such benefit must flow to the encumbered property or the community comprising the encumbered properties and their common areas or to adjacent or contiguous property. 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.~~

"*Encumbered Property*" means a particular lot or interest in real property encumbered by a private transfer fee covenant, the transfer of which triggers the obligation to pay a private transfer fee.

Enterprises means, collectively, the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation.

Excepted transfer fee covenant means a private transfer fee covenant ~~to pay a~~ which requires payment of private transfer fees to a covered association ~~that is used~~ and limits the use of such transfer fees exclusively ~~for the~~to purposes which provide a direct benefit ~~of the real property encumbered by the private transfer fee covenants.~~ to the burdened community, the owners and occupants of the burdened community, or to property adjacent or contiguous to the burdened community. Activities which provide a direct benefit to the burdened community shall include, without limitation: acquisition, improvement, maintenance, repair, or replacement of property owned, operated, or maintained by the covered association, other property within the burdened community, or property adjacent or contiguous to the burdened community; or cultural, educational, charitable, social, recreational, environmental, conservation or other similar activities and programs conducted within the burdened community or undertaken to enhance local schools, libraries, or public services which serve the burdened community.

Federal Home Loan Banks or *Banks* mean the Federal Home Loan Banks established under section 12 of the Federal Home Loan Bank Act (12 U.S.C. 1432).

Private transfer fee means a ~~transfer~~ fee, ~~including a~~ charge or payment~~,~~ imposed by a private transfer fee covenant~~, 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.~~ payable on an ongoing basis each time title to the encumbered property transfers (except for any transfers specifically exempted by the terms of the covenant). A private transfer fee ~~excludes~~ shall not include fees, charges, or payments, or other obligations—

(1) imposed by a court judgment, order or decree;

(2) imposed by or are payable to the Federal government or a State or local government;

(3) arising out of a mechanic's lien; or

(4) arising from an option to purchase or for waiver of the right to purchase the encumbered ~~real~~ property

(5) payable on a one-time basis that the transferor of the property contractually agreed to pay and which is simply memorialized in a memorandum of agreement, mortgage, or similar document recorded in the land records which, once satisfied, ceases to be an encumbrance on the property.

Private transfer fee covenant means a covenant that—

(1) purports to run with the land or to bind current owners of, and successors in title to, ~~such real~~ the encumbered property; and

(2) obligates a transferee or transferor of all or part of the encumbered property to pay a private transfer fee upon transfer of an interest in all or part of the encumbered property, or in consideration for permitting such transfer.

Regulated entities means the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, and the Federal Home Loan Banks.

Transfer means with respect to real property, the sale, gift, grant, conveyance, assignment, inheritance or other transfer of an interest in the real property.

§ 1228.2 Restrictions.

The regulated entities shall not purchase or invest in any mortgages on properties encumbered by private transfer fee covenants, securities backed by such mortgages or securities backed by the income stream from such covenants, unless such covenants are excepted transfer fee covenants. The Banks shall not accept such mortgages or securities as collateral, unless such covenants are excepted transfer fee covenants.

§ 1228.3 Prospective application and effective date.

This part shall apply only to mortgages on properties encumbered by private transfer fee covenants ~~created~~ which covenants were initially recorded on or after [INSERT DATE OF PUBLICATION OF THE ~~PROPOSED~~ FINAL RULE], and to securities backed by such mortgages, and to securities issued after that date backed by revenue from private transfer fees regardless of when the covenants were ~~created~~recorded. The regulated entities shall comply with this part not later than 120 days following the date of publication of the final rule in the Federal Register. Nothing herein shall be construed to preclude amendment of a private transfer fee covenant initially recorded prior to February 8, 2011 to expand the burdened community as contemplated by the terms of the private transfer fee covenant at the time it was initially recorded.

§ 1228.4 State restrictions unaffected.

This part does not affect state restrictions or requirements with respect to private transfer fee covenants, such as with respect to disclosures or duration.