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October 11, 2010

Via Email: regcomments@fhfa.gov
Alfred M. Pollard, Esq.
General Counsel
Federal Housing Finance Agency
Fourth Floor
1700 G Street NW
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ATTENTION: Public Comments
Guidance on Private Transfer Fee
Covenants (No. 2010-N-11)

Re: Comment to Guidance on Private Transfer Fee Covenants (No. 2010-N-11)

Dear Mr. Pollard:

Thank you for the opportunity to comment on the proposed Guidance on Private Transfer Fee Covenants (No. 2010-N-11) (the "Guidance") concerning restrictions on mortgages on properties encumbered by private transfer fees covenants. The members of the Association of the Bar of the City of New York, through its Committee on Cooperative and Condominium Law (the "Association") have extensive experience in the legal and financial matters involved in the operations of housing developments, homeowners associations, planned unit developments, condominium associations and cooperative apartment corporations (individually, a "Development", and collectively, "Developments") that would be affected by the proposed Guidance. The Association supports what it believes is the main objective of the proposed Guidance – to stop developers from receiving a never-ending source of income long after they have vacated their Developments. However, the Association objects to that portion of the

Guidance that would, in effect, prohibit transfer fees payable to the Development. While the Association acknowledges that the proposed Guidance would not directly prohibit Developments from collecting fees paid to it by owners in Developments ("unit owners") upon a transfer, because the Guidance would ban loans to unit owners in Developments that require such a fee, this prohibition would have a severe, adverse impact on unit owners and on Developments that collect a transfer fee, particularly as these monies are used by Developments as part of their operating budgets or as a reserve for future repairs and improvements.

The FHFA's Stated Concerns

The Federal Housing Finance Agency (the "FHFA") is seeking to issue a guidance to the Federal National Mortgage Association ("Fannie Mae"), the Federal Home Loan Mortgage Corporation ("Freddie Mac") and the Federal Home Loan Banks (the "Banks"), that they should not "deal in mortgages on properties encumbered by private transfer fee covenants" because "[s]uch covenants appear adverse to liquidity, affordability and stability in the housing finance market and to financially safe and sound investments." [1]

The Guidance defines a private transfer fee covenant as one

> attached to real property by the owner or another private party, frequently, the property developer, and requires a transfer fee payment to an identified third party, such as the property developer or its trustee, a homeowners association, an affordable housing group or another community or non-profit organization, upon each resale of the property. The fee typically is stated as a percentage (e.g., 1 percent) of the property's sales price and often survives for a period of ninety-nine (99) years. [2]

This broad definition includes fees payable by a unit owner to a developer and may include certain closing costs payable to, for example, a Development's managing agent for administrative costs in connection with a sale or transfer. Indeed, although the Guidance is clearly primarily aimed at developers who continue to receive revenue long after they have sold all their interests in the Developments, the FHFA asserts that the "Guidance does not distinguish between private transfer fee covenants which purport to render a benefit to the affected property and those which accrue value only to unrelated third parties."[3] It expresses concern that "unlike more typical annual assessments", fees that benefit the property "are likely to be unrelated to the

[1] FHFA Notice of Proposed Guidance, No. 2010-N-11 (the "Notice"), 75 Fed. Reg. 49932 (Aug. 16, 2010).

[2] FHFA Proposed Guidance, No. 2010-N-11 (the "Guidance"), 75 Fed. Reg. 49932 (Aug. 16, 2010). As noted in the Guidance, "many [of these] covenants are not intended for purely community purposes and instead, create purely private continuous streams of income for select market participants either directly or through securitized investment vehicles." *Id.*

[3] Notice, 75 Fed. Reg. 49932-33.

value rendered, and at times may apply even if the property's value has significantly diminished since the time the covenant was imposed." [4]

The FHFA's key concern, as expressed in the Guidance, is that

> [t]he typical one percent fee at the time of resale is neither a minimal nor a reasonable amount; further, such fees may be in excess of one percent. Such fees increase by a meaningful amount the seller's and potentially the buyer's burden at the time of a property sale. Expanded use of private transfer fee covenants poses serious risks to the stability and liquidity of the housing finance markets. [5]

As we show, these concerns do not apply to the transfer fees imposed in Developments in New York State.

New York Unit Owners Have Relied on the Income Received from Transfer Fees for Decades

"Private transfer fees" in the form of transfer taxes, flip taxes or entrance fees have been used in and relied upon by New York cooperatives, condominiums and homeowners associations for decades and have specifically been considered favorably by the New York State legislature and the Courts. See N.Y. Bus. Corp. Law § 501(c) ("shares of the same class shall not be considered unequal because of variations in fees or charges payable to the corporation upon sales or transfer of shares or appurtenant proprietary leases that are provided for in proprietary leases, occupancy agreements or offering plans, or properly approved amendments to the foregoing instruments"); *Fe Bland v. Two Trees Management Co. and 330 West End Apt. Corp. v. Kelly*, 66 N.Y.2d 556, 489 N.E.2d 223, 498 N.Y.S.2d 336 (N.Y. 1985) (upholding transfer fees when provided for in proprietary leases or by-laws and when proportional to number of shares of selling shareholder; modified by N.Y. Bus. Corp. Law. § 501(c) providing that such fees need not be proportional to number of shares); *Holt v. 45 East 66th Street Owners Corp.*, 161 A.D.2d 410, 555 N.Y.S.2d 340 (App. Div., 1st Dep't, 1990) (upholding transfer fee of $50 per share); *Mogulescu v. 255 West 98th Street Owners Corp.*, 135 A.D.2d 32, 523 N.Y.S.2d 801 (App. Div., 1st Dep't, 1988) (upholding transfer fee of 15% of profit and declining to 5% over period of time); *Amer v. Bay Terrace Cooperative Section II, Inc.*, 142 A.D.2d 704, 531 N.Y.S.2d 33 (App. Div., 2d Dep't, 1988) (upholding option waiver fee); *Quirin v. 123 Apartments Corp.*, 128 A.D.2d 360, 516 N.Y.S.2d 218 (App. Div., 1st Dep't, 1987) (upholding transfer fee); *Pomerantz v. Clearview*

[4] Guidance, 75 Fed. Reg. 49933.
[5] *Id.*

Gardens, 77 A.D.2d 651, 430 N.Y.S.2d 387 (App. Div., 2d Dep't, 1980) (upholding cooperative's option waiver fee); *Berglund v.411 East 57th Corp.*, 127 Misc.2d 58, 488 N.Y.S.2d 947 (App. Term, 1st Dep't, 1985) (transfer fee of 1% not valid because not enacted by shareholder vote); *Jamil v. Southridge Cooperative Section No. 4 Inc.*, 102 Misc.2d 404, 425 N.Y.S.2d 905 (App. Term, 2d Dep't, 1979) (upholding cooperative's option waiver fee); *Mayerson v. 3701 Tenants Corp.*, 123 Misc.2d. 235, 473 N.Y.S.2d 123 (Sup. Ct., N.Y. Co., 1984) (upholding transfer fee of 7 ½ %); *Raimondi v. Board of Managers of Olympic Tower Condominium*, 53 A.D.3d 330, 859 N.Y.S.2d 191 (App. Div., 1st Dep't, 2008); Richard Siegler and Eva Talel, "Condominiums: Restraints on Alienation", New York Law Journal, May 2, 2007, at 3, col. 1.

The collective experience of the Association's lawyers who practice in this area is that transfer fees payable to the Development, which are either (i) contained within a Development's governing documents and which can be changed or repealed only by a vote of the members of the Development or (ii) adopted by the members of the Development, are an essential element of the Development's budget. These fees have been utilized in New York for many years and by many Developments without discernible, negative effects. [6] The fees are usually based on a percentage of the sale price, a percentage of the profit to be realized by the seller, a specified amount per share in a cooperative or a multiple of the carrying charges for the unit. In New York, it is the unit owners who determine whether such a fee should be charged and, if so, the form it should take.

Transfer fees are used, in some Developments, as part of the operating budget and, in others, for a reserve so that when – for example – a roof needs to be replaced, the board does not have to levy an assessment that unit owners may have difficulty paying in addition to their monthly carrying charges. This is particularly so as "hard costs", such as labor, real estate taxes, water and sewer charges, and insurance premiums, have increased so extensively over the last few years that many unit owners cannot afford to pay their monthly charges and, at the same time, be burdened by an assessment. [7]

In order to be valid and effective, these transfer fees must be expressly authorized by the Development's governing documents. Some are included in the governing documents at the time of the initial offering of the Development's units, and must be fully disclosed in the offering materials for the Development. After the developer no longer controls the Development, the unit

[6] According to recent survey by the Community Associations Institute, forty-nine percent (49%) of Developments nationwide impose a transfer fee that benefits the Development. Community Associations Institute, Department of Government & Public Affairs, *For the Common Good: Use of Community Transfer Fees by Community Associations*, September 20, 2010. The Council of New York Cooperatives and Condominiums estimates that at least fifty percent (50%) of apartment cooperatives in New York currently impose some kind of transfer fee.

[7] In addition, New York has certain communities where transfer fees are payable, ultimately, to a governmental or quasi-governmental agency (i) to pay back taxes for properties that had been *in rem*; (ii) to pay down a subsidized mortgage; or (iii) to pay the government for some other purpose.

owners can repeal or modify the transfer fee by vote as provided in the governing documents. The majority of these transfer fees, however, are enacted by the unit owners through an amendment to the governing documents after control of the Development has passed from the Developer. Therefore, the unit owners and not the Developer control these transfer fees, and they use these fees to make certain that the Development has adequate capital to fund improvements and maintain the Development, which funds would otherwise have to be raised by increases in maintenance fees or common charges, or by the imposition of assessments.

If the Guidance were to be adopted as drafted and mortgages on these Development units prohibited, the Developments would be forced to eliminate such fees, which would result in economic hardships for the Developments that have relied for years upon these transfer fees and in increased costs to all unit owners. While it is true that a unit owner is required to pay the transfer fee at the time of his or her sale of the unit, this existing practice poses less of an imposition in that the selling unit owner generally has available funds from the sale of the unit. In addition, sellers and buyers take the imposition of the transfer fee into account when negotiating the sale price for the units. An assessment would place a burden on all unit owners when cash might be unavailable, and increased maintenance or common charges would create a significant rise in every unit owner's monthly carrying charges. Finally, although the selling unit owner who pays the transfer fee does not reap the benefit of his or her payment of the fee, the seller has already reaped the benefit of the transfer fees paid by the unit owners in the Development who sold their units before the seller's transfer. Further, the selling unit owners have contributed to the "wear and tear" of the materials which may require upgrade or replacement after they sell their apartment.

Recommended Alternate Definition

Accordingly, the Association suggests that the definition of private transfer fee as set forth in the Guidance be modified, as follows:

> A private transfer fee covenant is attached to real property which is part of a Development (defined below) by the developer, sponsor, owner or another private party and requires that a fee be paid upon each resale of the property to an identified third party, such as the property developer or its trustee, an affordable housing group, or another community or non-profit organization that is not responsible for all or substantially all of the ongoing maintenance, replacement, repairs, additions, alterations, operation or improvement of the property or the development, homeowners association, planned unit development, condominium association or apartment cooperative corporation to which the property belongs or forms a part (the "Development"). The private transfer fee is typically stated as a percentage (e.g., 1 percent) of the property's sales price; the obligation to pay the fee often survives for a period of ninety-nine (99) years; and it cannot be changed or

eliminated by property owners in the Development. A private transfer fee does *not* include a payment:

(a) that is (i) created or imposed by the initial state-regulated governing documents of a Development, such as its declaration, by-laws, proprietary lease or covenant, conditions and restrictions (the "governing documents") or (ii) created, imposed or modified, or may be repealed, by an affirmative vote of the property owners as may be required in the governing documents;

(b) that is required to be paid to the Development or its agent at the time of or in anticipation of a sale, transfer or assignment (the "Transfer"); and

(c) that is used for the ongoing maintenance, replacement, repairs, additions, alterations, operation or improvement of the Development or amortization of any underlying mortgage on the Development, including deposit into a reserve fund, working capital fund or other similar fund for the benefit of the Development or its members, shareholders or unit owners.

In addition, the following shall not constitute a private transfer fee: (i) the one-time closing costs and closing adjustments typically incurred in the community in connection with a Transfer of similar property which are payable at or prior to the closing; (ii) in the case of a Transfer by a developer or sponsor, as grantor to the initial purchaser (the "Initial Closing"), such closing costs and closing adjustments as are typically incurred in the community in connection with the Transfer by a developer or sponsor, provided same was disclosed in writing to purchasers prior to the time they contracted to purchase the property or otherwise acquired their interest in the Development and provided further that the costs and adjustments are payable on time only at or prior to the Initial Closing or as a closing obligation of the Purchaser, which expressly survives the Initial Closing; or (iii) monies paid or to be paid to a governmental or quasi-governmental agency.[8]

[8] The Condominiums and Cooperatives Committee of the Real Property Section of the New York State Bar Association concurs with this proposed revision to the definition of a 'Private Transfer Fee'.

FHFA's Specific Concerns
Do Not Apply to the Transfer
Fees Imposed by New York Properties

The specific concerns raised by the Guidance with respect to New York transfer fees are addressed, as they relate to New York Developments, as follows:

(a) *A typical one percent fee is not a reasonable amount*: Not all New York transfer fees are expressed as a percentage of the sale price; they are calculated based on a percentage of the sale price, a percentage of the profit to be realized by the seller, a specified amount per share in a cooperative or a multiple of the carrying charges for the unit. In any event, however, it is the members of the Development who determine the proper fee because the fees are contained in the Development's governing documents and can be changed by the apartment owners in accordance with the terms of those documents. *Levandusky v. One Fifth Ave. Apartment Corp.*, 75 N.Y.2d 530, 553 N.E.2d 1317, 554 N.Y.S.2d 807 (N.Y. 1990); *Pello v. 425 E 50 Owners Corp.*, 19 Misc. 3d 1125(A), 862 N.Y.S.2d 816 (Table), 2008 WL 1869651 (Sup. Ct., N.Y. Co., 2008). The fees may not be related to the unit's interest in the Development (percentage of common interests in the condominium or homeowners' association or shares in the apartment cooperative corporation), but such lack of relation has specifically been authorized by statute. [9]

(b) *The fee increases the seller's (and buyer's) burden at transfer and increases the costs of home ownership*: The New York transfer fee is generally first disclosed by real estate brokers in any listing of a unit or as part of marketing materials and is considered during the course of contract negotiations. Ultimately, the economic impact of the transfer fee is typically reflected in the negotiated sale price.

(c) *The fee limits property transfers or renders them legally uncertain*: New York's transfer fees have not been shown to have a negative impact on transfers. They are always disclosed in the Development's governing documents, which, in the case of a condominium or homeowners' association, are recorded where deeds are recorded in that particular county. The governing documents are reviewed by the attorneys for the purchasers prior to the execution of the sales contract. Being fully disclosed and part of the contract negotiations, New York's transfer fees are not hidden and do not create any "legal uncertainty" at any time during the sale process.

(d) *The fee detracts from the stability of the secondary mortgage market*: Although this may be true of private transfer fees that are fees that "run with the land", it is not true of New York's transfer fees. These fees are generally not imposed on foreclosure sales and do not impact the proceeds received by mortgagees or their investors from foreclosure sales. The fees do not promote instability; rather, the effective elimination of such transfer fees as a result of the Guidance, as currently drafted, would render many Developments financially unstable or impose increased burdens on the unit owners, rendering them, and their mortgages, financially insecure.

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[9] N.Y. Bus. Corp. Law § 501(c); see page 3, *supra*.

(e) *The fee exposes lenders, title companies and secondary market participants to risks from unknown potential liens and title defects*: In New York, lenders, title companies, and secondary market participants are, or are obligated to be, aware of the existence of transfer fees. The fees imposed by homeowners or condominium associations are set forth in recorded, governing documents that are reviewed by lenders and title companies. With respect to cooperative apartment units, whose governing documents are not recorded, purchasers rarely obtain title insurance on the shares of stock they are purchasing or the appurtenant proprietary leases, and if title insurance is obtained, the title company demands copies of, and reviews, the corporation's governing documents, as well as the contract of sale, in which the transfer fee is also set forth. In addition, the form contract of sale approved by the New York State and New York City Bar Associations provides disclosure of a transfer fee. [10]

(f) *The fee contributes to reduced transparency for consumers because they often are not disclosed by sellers and are difficult to discover through customary title searches, particularly by successive purchasers*: This is simply not true with respect to New York's transfer fees. As stated above, they must be contained in the Development's governing documents to be effective and such document is either of record (and thus discoverable in a customary title search) in the case of condominium and homeowners associations, or in the case of cooperative apartments for which there is no recorded title, supplied to the purchaser's attorney for review prior to the execution of the sale contract and disclosed in the form contract of sale. In addition, as noted above and in footnote 9, the standard form of contract provides for a disclosure concerning a transfer fee.

(g) *The fee represents dramatic, last-minute, non-financeable out-of-pocket costs for consumers and can deprive subsequent homeowners of equity value*: This is not the case with New York's fees, since they are part of the Development's governing documents and are always known by the seller and disclosed to the purchaser in the sale contract, if not earlier.

(h) *The fee complicates residential real estate transfers and introduce confusion and uncertainty for home buyers*: This has not been the case to date in New York with its transfer fees. It is a simply calculated fee that is fully disclosed prior to the execution of a sales contract, for which provision is made in the contract so there is no confusion or surprise at the closing. This is not a fee that is buried in an initial deed for a unit which may not be reviewed by a future purchaser or by his or her attorney or title insurer.[11]

Although the FHFA has legitimate concerns about private transfer fees payable to a developer, such concerns are not present in New York's transfer fees. Rather than being imposed on a powerless seller or purchaser by a developer, the fee is controlled by, and imposed by, the unit owners themselves on themselves. The private power of a Development's unit owners to

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[10] *See* Form Contract of Sale for Cooperative Apartment Prepared by the Committee on Condominiums and Cooperatives of the Real Property Section of the New York State Bar Association and Approved by the Committee on Cooperatives and Condominiums of the Association of the Bar of the City of New York and the New York County Lawyers' Association, 7/01, paragraph 1.19.

[11] The transfer fee is also disclosed in the real estate broker's term sheet for a unit.

determine how they fund the Development's reserves and maintenance and repair projects should not be decreased – and possibly eliminated – by the enactment of the proposed Guidance, which would be its practical effect. Instead, the Guidance should be revised, as set forth above, to exclude fees as are customarily charged in New York.

Closing Costs and Adjustments

At a typical sale closing for a Development unit (either for a real property interest such as a condominium unit or a personal property interest such as shares in a cooperative apartment corporation with an appurtenant real property interest in the form of a proprietary lease), a variety of fees and taxes are imposed on the seller or purchaser, depending on the contract of sale or the applicable state or local law. Examples of such fees are as follows:

> Fee to the transfer agent and/or managing agent for the Development in compensation for its services in connection with the closing transaction;
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> State and local transfer taxes and tax filing fees (i.e., in New York, the state imposes a transfer tax on sellers ($2 for each $500 of consideration) and a tax of 1% of consideration on purchasers when the consideration exceeds $1,000,000, and a number of municipalities, including New York City, impose a transfer tax on the seller);
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> Mortgage recording tax (i.e., in New York, both the state and local municipalities impose such a tax, except for a small percentage, on the mortgagor);
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> Fees imposed by title and abstract companies for searches and other services;
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> Title insurance premiums; and
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> Local recording fees.

At closings for the initial sale of a Development unit by the developer or sponsor, some Developments charge the purchaser a disclosed fee or require that the purchaser make a contribution to the Development's capital fund. In addition, at such initial closings, the developer typically shifts certain fees that are otherwise imposed on the seller to the purchaser, and collects reimbursement from the initial purchaser for certain costs incurred by the developer,

such as previously paid mortgage recording tax. In some Developments, the developer collects post-closing a reimbursement for further costs incurred by the developer, such as fees incurred in obtaining tax abatements on behalf of the Development. *In all such cases*, however, these fees are fully disclosed in the offering materials for the Development (which must be supplied to all unit offerees after having been accepted for filing by the New York State Office of the Attorney General) and in the contract of sale for the unit. See New York General Business Law §352-e, et seq.; 13 N.Y.C.R.R. Parts 18, 20, 21, 23, 24 and 25.

Thus, these fees should not be considered "private transfer fee covenants" for purposes of the Guidance.

Conclusion

The Association strongly recommends the adoption of the Guidance, as modified herein. The modifications are necessary in order to maintain and promote the financial health and physical condition of New York Developments and thus the mortgages on its units.

Very truly yours,

Committee on Cooperative and Condominium Law
Association of the Bar of the City of New York

Andrew P. Brucker, Esq., Chair
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Michael T. Manzi, Esq., Chair of Subcommittee on FHFA Guidance