VIA EMAIL (REGCOMMENTS@FHFA.GOV) AND FEDERAL EXPRESS

October 15, 2010

Alfred M. Pollard, General Counsel
Federal Housing Finance Agency, Fourth Floor
1700 G Street, NW
Washington, DC 20552
Attention: Public Comments "Guidance on Private Transfer Fee Covenants (No. 2010–N–11)"

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

Dear Mr. Pollard:

The Federal Home Loan Bank of New York ("FHLBNY") appreciates this opportunity to comment on the Federal Housing Finance Agency's ("FHFA") proposed "Guidance on Private Transfer Fee Covenants" ("Proposed Guidance"). The FHFA has indicated that the entities it regulates should not deal in mortgages on properties encumbered by Private Transfer Fee Covenants ("PTFCs") because, in its view, such covenants appear adverse to liquidity, affordability and stability in the housing finance market and to financially safe and sound investments. The Proposed Guidance would extend to mortgages and securities held by the Federal Home Loan Banks ("FHLBanks") as investments or as collateral for advances.

Observations on the Background Behind Private Transfer Fees

Private transfer fees, also referred to as a "flip tax", were originally applied to New York City apartment buildings that converted to a co-op ownership structure. In its earlier use, the fees were designed to "tax" owners who purchased newly converted co-ops and then quickly "flipped" the units to make a profit. The original owners were typically renters who took advantage of favorable discounted "insider" pricing and then quickly re-sold the units at market rates.

Co-op boards' revenue streams are typically limited to monthly maintenance from shareholders and rental from commercial units. Additionally, the private transfer fee is another source of revenue typically used to fund reserves for capital improvements and building repairs. In addition, shareholders experience the benefit of lower maintenance fees as increases in same are subsidized by the transfer fee payments. With a high proportion of aged, pre-World War II ("pre-war") construction buildings in New York City, co-op buildings that have incorporated a PTFC do benefit significantly over those that must only rely on the traditional sources of income (i.e. maintenance from shareholders and rental from commercial units). Income derived from transfer fees allow for a more stable reserve fund to keep up with the ongoing maintenance and improvement of these aging structures, and, in so doing, preserve and improve upon the value of the shareholder's investment. Over time, the PTFC fees can provide for adequate reserves to keep pace with the increasing cost of funding significant improvements and repairs because fixed-percent fees are generated on the sale of co-op units that also appreciate in value. Strong reserve funds also diminish the need for "special assessments" on shareholders to cover major, unexpected building repairs.

To a much lesser extent, private transfer fees have also been applied to condominium and planned urban development ("PUD") projects. Similar to co-ops, the fees in this case benefit the homeowners, as they are used to fund the maintenance and repairs of the common areas of the homeowner association.

101 Park Avenue
New York, NY 10178-0599
T: 212.681.6000
F: 212.441.6890
www.fhlbny.com

However, more recently a new trend has surfaced whereby housing developers have begun imposing 99-year PTFCs (known also as capital recovery fees, resale fees, or re-conveyance fees) on new homes. This particular practice requires sellers to pay a percentage of the sale price of their home to the developer when the homeowners sell their home. Such fee covenants appear to only benefit either the developer by providing a lucrative and long lasting revenue stream, or the investors in securities backed by these revenue streams. The practice of securitizing private transfer fee income streams has also begun.

FHLBNY Thoughts and Concerns

1. **Developer Covenants** – The FHLBNY shares the FHFA's concern over the negative impact that 99-year PTFCs currently being adopted by certain housing developers will have on the marketability and valuation of affected homes and on the financial health of homeowners. We share the belief that such fees are simply in place to provide a continuous stream of income for developers and/or other investors through securitized investment vehicles. We agree that FHLBanks should not lend against mortgage collateral or purchase mortgage loans that are subject to this more recent application of transfer fee covenants by housing developers.

2. **New York City Co-op Covenants and Collateral Impact** – From a collateral perspective, we are concerned by the proposed 'broad brush' application of the Proposed Guidance and the potentially serious impact that it will have on member banks who are active lenders to the New York City co-op market and who pledge such loans to the FHLBNY as collateral. We do not agree that all applications of PTFCs are inherently bad and we believe that distinctions can and should be made. The New York City housing market has one of the largest concentrations of co-op units in the country. Many of these co-op units are within older, pre-war construction building stock. These aging housing structures require significant ongoing maintenance, improvements and repairs to ensure that the buildings and the co-op investment of all shareholders retain a market value that is in sync with current markets. To accomplish this, co-op boards must diligently maintain adequate reserve funds to cover significant improvement and modernization projects, expected and unexpected infrastructure repairs, as well as keeping pace with ongoing maintenance programs.

   While monthly maintenance fees from shareholders and rental income from commercial tenants, if available, do provide the traditional income stream to fund some of these efforts, the likelihood of facing expected and unexpected large scale repairs or improvements can easily overwhelm limited reserve funds. Without adequate reserve funds, the result can be special assessments levied against all shareholders to cover shortfalls. Special assessments may result in the addition of significant stress on the financial health of household finances. The use of income derived from private transfer fees to strengthen building reserves for New York City co-op buildings is actually viewed as a positive feature for current and prospective co-op shareholders. Co-op buildings that are well maintained and managed by responsible co-op boards survive and thrive in New York City, and add stability to the local housing market. A key success factor for many of the older buildings is having a healthy and adequate reserve fund. Private transfer fees also help to keep shareholder monthly maintenance fees lower, reduce the likelihood of unexpected special assessments, and help maintain stable, predictable housing expenses for homeowners.

   It is estimated that approximately 50% of New York City co-op buildings have adopted a PTFC which is often set forth in their proprietary leases and co-op bylaws. The impact of applying a complete prohibition of PTFCs will result in disqualifying a currently eligible and actively used form of collateral that is being pledged by FHLBNY members.

   The FHLBNY respectfully requests that the FHFA consider distinguishing between PTFCs which render a benefit to the affected property's homeowners association, which are customary in the

New York City co-op market, from those unscrupulous PTFCs which accrue value only to unrelated parties. Without such modifications, the application of the Proposed Guidance to the New York City co-op market will have negative unintended consequences on certain FHLBNY members that are active lenders in this market. In addition, there could possibly be a disruption in the liquidity and stability within this market.

Although the above speaks directly to New York City co-op covenants, it is also important to be cognizant of and recognize that PTFCs do exist on condominium and PUD projects. Those PTFCs with the intention of benefitting homeowners and their community should not be considered as detrimental to the housing market.

In co-op buildings where private transfer fees are in place, sellers who are responsible for paying the fees have had the benefit of lower monthly maintenance fees during their period of ownership as a result of the fact that private transfer fees have been charged to other sellers in the past. It is the homeowners of the co-op units in these buildings that have benefited. All homeowners in these buildings have been purchasers and eventually all will be sellers. Yet, it is the action of the marketplace itself that will ensure that the fees are reasonable and acceptable within that given market. The New York City marketplace has surely accepted such fees.

The marketplace does not address whether the fees are proportional or related to the purposes for which the fees were to be collected, nor should we. Insisting that the fees be proportional or related to certain purposes will only add additional costs unnecessarily, such as engineering, accounting and legal costs. The marketplace should be the determinant of what works and what does not work.

3. **Acquired Member Assets Impact** – Co-op share loans are not eligible assets for purchase under the Mortgage Partnership Finance® ("MPF"®) acquired member asset program, so there will be no negative impact from the application of the Proposed Guidance in this regard. While condominium and PUD home loans are actively purchased through the MPF program, our research has indicated that the use of PTFCs are not prevalent in this market as is the case with co-ops. The fees in this case benefit the homeowners as they are used to fund the maintenance and repairs of the common areas of the homeowner association. However, actually being able to detect the presence of PTFCs in the mortgage documents will be difficult as there does not appear to be a uniform market convention on how these fees are disclosed and documented. Other than formally prohibiting the sale of such loans and documenting this in the MPF Program Servicer Guide, a prohibition on purchasing affected loans, expanding existing representations and warranties provided by participating financial institutions, and instructing the quality control service provider to look for the presence of PTFC during their QC process, the FHLBanks are limited in their ability to detect such loans. The FHLBanks could benefit from an industry standardization initiative in the disclosure of PTFCs within the closing documents.

4. **Investments Impact** – The FHFA's Proposed Guidance notes that the "draft Guidance is based on the view that investments in mortgages on properties with private transfer fee covenants *and securities designed to generate income from the fees* are not acceptable for the regulated entities." 75 F.R. 49932 (August 16, 2010) [emphasis added]. In describing the Proposed Guidance, the FHFA states the Proposed Guidance directs the regulated entities not to purchase or invest in "*securities backed by private transfer fee revenue*." *Id.* at 49933 [emphasis added]. However, the text of the Proposed Guidance itself not only prohibits the purchase of, and investment in, securities backed by private transfer fee revenue, but expands the prohibition to *all securities* backed by a mortgage encumbered by a PTFC.

   The text of the Proposed Guidance states that Fannie Mae and Freddie Mac "should not purchase or invest in any mortgages encumbered by private transfer fee covenants *or securities backed by such mortgages*." *Id.* at 49934 [emphasis added]. The provision is expanded to the FHLBanks by stating

"The Banks should not purchase or invest in such mortgages or securities or hold them as collateral for advances." *Id.* The text of the Proposed Guidance prohibits the purchase or investment in securities backed by "such mortgages," presumably referring to the immediately preceding phrase which prohibits the purchase or investment in "any mortgages encumbered by private transfer fee covenants." Thus, the text of the Proposed Guidance appears to unnecessarily expand the coverage of the Proposed Guidance as expressed by the FHFA in the Supplementary Information and is unnecessary to achieve the FHFA's goals.

The FHLBNY supports the FHFA's prohibition on purchasing or investing in securities *designed to generate income* from private transfer fees used to benefit developers or as expressed in the Supplementary Information, and the prohibition of the acceptance of such securities as collateral. However, the FHLBNY has significant concerns with the difficulty of determining whether a security may have included in the underlying collateral mortgages that may be subject to a PTFC, which, if the Proposed Guidance is strictly construed, would disqualify an entire security. The FHLBNY does not believe that such a prohibition is necessary to achieve the FHFA's objectives.

5. **Monitoring Concerns** –Since we expect that the other FHFA regulated entities will comply with FHFA issued guidance prospectively from the date of the guidance issuance, we do not envision being required to "test" agency MBS issued after the effective date of the guidance. However, based on recent experience with other FHFA guidance and subsequent guidance clarifications, we do have concerns about whether FHFA will require "testing" of securities (purchased as investments or pledged as collateral) that were issued prior to the effective date of the new Guidance. As a general rule, testing underlying mortgages of mortgage-backed securities is significantly problematic, and, if ultimately required, should be limited to securities issued after the effective date of the guidance.

   The text of the Proposed Guidance would appear to require the FHLBanks to examine the mortgages backing every security, prior to purchasing or investing in that security or accepting such security as collateral, to determine whether any of the mortgages backing that security are encumbered by a PTFC. In the event a FHLBank discovered a PTFC on *one* mortgage backing the security, the Proposed Guidance would prohibit the FHLBank from purchasing or investing in that security or accepting that security as collateral. If this is the intent of the Proposed Guidance, we believe that this degree of "purity" testing will be an impossible standard to accurately verify, and a difficult standard to uphold. In fact, the FHFA recognizes that PTFCs "often are not disclosed by sellers and are difficult to discover through customary title searches." *Id.* at 49933. The difficulty in discovering PTFCs is exacerbated in the purchase of or investment in securities or acceptance of such securities as collateral, which may require the review of hundreds or thousands of mortgages to ensure they are not encumbered by PTFCs. From a securities investment or securities collateral perspective, similar challenges and difficulties will be faced in enforcing the perceived requirements of the Proposed Guidance as is being encountered in enforcing the requirements of the Guidance on Subprime and Non-traditional Lending. The end result may be the disqualification of otherwise sound collateral because the hurdle for verifying "purity" will be too high.

   Monitoring and testing for the presence of PTFCs will be no less challenging for mortgage loans pledged as collateral because, as the FHFA has acknowledged, PTFCs "are difficult to discover through customary title searches." As it pertains to co-ops, such covenants are difficult to locate in typical loan closing documentation. Similar challenges exist with condominium loans and homes within developments that have imposed a 99-year PTFC. We believe consideration should be given to have co-op, condominiums and PUDs excluded from this guidance and the focus instead be directed to those transfer fees which housing developers are imposing under the guise of a 99-year private transfer fee covenant. For the situations warranted, we do believe that realistic and reasonable efforts can be applied to ensure adherence to the spirit and primary objective of the Guidance. This can include informing members of the prohibition on pledging such loans as

collateral, requiring enhanced member certifications that such loans are not pledged, and conducting reasonable assessments of loans reviewed during on-site visits. We believe that the pursuit of compliance verification much beyond these standard practices will not be practical or meaningful.

The FHLBanks' mission is to provide a reliable source of liquidity to meet the housing finance and credit needs of their communities. Due to the potential for excessive verification and monitoring burdens, adoption of the Proposed Guidance as written will prohibit the FHLBNY from efficiently meeting its mission with respect to a certain segment of the market for co-ops, condominiums, and potentially the financing of homes in a PUD where a PTFC may exist. Members may not be able to efficiently liquefy these mortgages with the FHLBNY so they can extend additional credit in the communities they serve. As previously noted, not all PTFCs are created equal. As such, the FHLBNY believes that a distinction must be made between those "good" PTFCs that provide value in which they benefit the affected property's homeowners association and community as opposed to those "bad" PTFCs which accrue value only to unrelated parties. The FHFA should also carefully consider the extent to which the FHLBanks will be required to verify that mortgages supporting an MBS prior to pledge or purchase comply with the final Guidance to be issued. The monitoring requirements imposed on the FHLBanks should result in the FHLBanks exercising reasonable efforts to ensure adherence to the spirit of the Guidance.

Concluding Remarks

In conclusion, should the FHFA decide to issue Guidance on this subject, the FHLBNY respectfully requests that such Guidance:

1. Exclude co-op share loans, condominiums and PUDs from the purview of the Guidance, realizing that the marketplace has accepted such fees;
2. Prohibit regulated entities from investing in securities backed solely by private transfer fee revenue;
3. Prohibit purchase and collateral use of 1-4 family mortgage loans burdened with 99-year PTFCs;
4. Establish prudent and reasonable compliance requirements prospectively to mortgages originated and securities issued after the Guidance issuance date; and
5. Allow for prudent and reasonable monitoring processes for the review of mortgages for purposes of determining whether private transfer fees exist.

On behalf of the Federal Home Loan Bank of New York, we thank the FHFA for its consideration of these comments.

Sincerely,

Paul B. Héroux
SVP, Head of Member Services Group