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HOT TOPIC ALERT

Private Transfer Fees

Private transfer fees (PTF) are a real estate fee paid to a third party during a sale. Around the mid-to-late 2000s, there was a rise in using PTFs as investment opportunities. At one point, it seemed as though PTFs would become the wave of the future for many real estate development projects. However, it quickly became clear that the benefit of PTFs often came at the expense of real estate consumers. As awareness over the potential downsides of PTFs expanded, so too did federal and state legislation prohibiting them.

In this Hot Topic Alert, we provide a brief history of private transfer fees, explain the issues that are inherent in PTFs (particularly when the beneficiary is a private individual or business), and summarize the current state of the law regarding PTFs. We also touch on how the National Association of REALTORS® and its regional associations helped to stop the rise of problematic PTFs.

Private transfer fees, also referred to as reconveyance fees and third-party transfer fees, are fees that must be paid to a third party each time the property is sold. Among others, the third party the PTF is paid to may be one or more profit seeking individuals or entities, often developers, a charitable organization, or an entity tasked with managing the property at hand. Sometimes, rather than being paid to a single third party, the fees are divided among a group of persons or entities. PTFs are calculated as a percentage of the property's sale price and paid, typically by the seller, at closing.

Legally, PTFs operate as covenants that attach to the property. In a common PTF scenario, a developer adds a covenant to the deed of each home sold that attaches to the initial sale and all future sales of the property. The terms of the covenant require the fee to be paid to the developer each time the home is sold. PTF obligations continue as long as the PTF is in effect, typically 20 or 99 years.

Private transfer fees come in different variations, usually related to the terms of the covenant and who receives the fees. A stewardship funding arrangement, for example, uses transfer fees to fund stewardship of the land being transferred. Often the favorability and permissibility of private transfer fees relates in some way to the beneficiary of the fee. PTFs with purely private beneficiaries tend to be viewed critically by the public (and under state and federal laws) while those with more charitable beneficiaries, like land conservation organizations, tend to be viewed more favorably, and are more likely to be permitted.

Historically, some variant of PTFs were used for HOAs and government transfer taxes. For example, an HOA transfer fee may be imposed to cover the administrative costs such as updating records and revising documents incurred by the HOA in transferring the property. The rise of the fees for other uses began around the mid-2000s. One of these early unique uses came in the form of a settlement agreement. The Sierra Club and Sierra Foothills Audubon Society sued the City of Roseville for approving a new housing development alleging that the City's approval violated California law. Ultimately, the environmental groups and Roseville settled. As part of the settlement agreement, a transfer fee of 0.5% of the gross sales price on every resale of a single-family home in West Roseville for 20 years. The fee was to be paid to the nonprofit Placer Land Trust for use in buying local greenspaces.

PTFs as a private investment agreement were first devised by Freehold Capital Partners. The company even attempted to obtain a business process patent on PTFs, but ultimately abandoned the application. Freehold Capital Partners and other proponents heralded the fees (which it now refers to as "capital recovery fee assessments") as a mechanism for allowing developers to spread out the cost of building community infrastructure such as roads and utilities over a period of time, with each transfer fee payment to the developer effectively reimbursing the developer for the cost of the infrastructure. Proponents claimed this in turn allowed the developers to lower the initial price of the home and provide greater access to the initial property purchaser. Yet at the same time, Freehold both promoted the fees as an investment tool and itself took 1/3 of the fees in a typical arrangement as payment for its licensor services.

Private transfer fees also began to be used as a mechanism for funding charitable organizations. The most notable example of this approach is the Lennar Charitable Housing Foundation ("LCHF") (now subsumed into Lennar's Homeful non-profit). Lennar imposed a private transfer fee of 1/20th of 1% of the sale price, which it called an "endowment fee." The fee funded LCHF which in turn gave funds to local homeless and affordable housing organizations. Although the causes funded by the fees are worthy, these types of arrangements were often criticized as "forced charity," and giving to charity in a corporation's name at the consumer's expense.

The use of private transfer fees quickly expanded, as did the opposition to them. State and federal regulators and legislatures quickly took notice of the increasing use of PTFs and the well-reasoned and vocal opposition to them and began passing legislation addressing them. Between 2008 and 2010, eight states enacted statutory prohibitions on the enforcement of private transfer fee covenants. As of 2021, private transfer fees are prohibited in most situations in forty-two states.[1] .

LANDMARK STATE AND FEDERAL LEGISLATION

One of the most impactful pieces of regulation regarding private transfer fees came at the federal level. In 2012, the Federal Housing Finance Agency ("FHFA") issued a rule that limited Fannie Mae, Freddie Mac, and the Federal Home Loan Banks' ability to deal in mortgages with PTFs. The rule, 12 CFR §1228, largely prohibits dealing in mortgages encumbered by PTFs but offers some exceptions. Specifically, the rule does not prohibit dealing in mortgages with PTFs that directly benefit the encumbered properties. Examples of PTFs that directly benefit the property include private transfer fees paid to homeowners' associations, condominiums, cooperatives, and some tax-exempt organizations that use the PTF proceeds to directly benefit the property. Additionally, the rule is prospective only, so it does not impact transfer fees that were in place before February 8, 2011, the date the proposed rule was first published.

Also on the federal level, following inquiring correspondence from the NAR and fellow industry organizations, HUD's General Counsel confirmed that private transfer fees violate HUD's regulations at 24 CFR 203.41, which prohibit "legal restrictions on conveyance," defined to include "limits on the amount of sales proceeds retainable by the seller."

[1] Alabama, Alaska, Arizona, Arkansas, Colorado, Connecticut, Delaware, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Kansas, Kentucky, Louisiana, Maine, Maryland, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Jersey, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, and Wyoming.

The bulk of state legislation restricting private transfer fees was passed between 2008 and 2013, although some changes to private transfer fee laws continued to be made after the height of legislation. For example, in 2017, California, which had at one time been one of the most favorable states for private transfer fees, passed Cal. Civ. Code §1098.6, which prohibits private transfer fees in most circumstances.

The details of state laws regarding private transfer fees vary greatly, however, common issues addressed are one of more of the following: restrictions on the use of PTFs, disclosure requirements for PTFs, and enforcement policies for existing PTFs. All states that prohibit private transfer fees also provide that the prohibited fees, liens, or covenants are void or unenforceable.

It is important to note that while states largely prohibit private transfer fees, each state has carve- outs that are either not considered private transfer fees or are exempted from the prohibition. For example, California's relatively new PTF legislation does not prohibit transfer fees if they are used exclusively to support the encumbered property or to support cultural, education, charitable, recreational, environmental, conservation, or similar activities. These are representative examples of common exceptions under state laws.

As to PTFs that were in effect before relevant legislation, a few states allow PTF provisions that were in place before the statutory prohibition, particularly if recording and disclosure requirements were complied with. Connecticut, Pennsylvania, South Carolina, and Texas fall into this category. The statutes in many more states[2], by contrast, specifically state that no presumption of validity will be applied to private transfer fee agreements entered into before the date they became statutorily prohibited. Washington is a bit of a hybrid state, in that there is no presumption of validity for agreements entered into before PTFs became prohibited, but the statute also notes that such an obligation may be enforced if notice was recorded before that date.

Twenty-one states[3] specifically require disclosure of private transfer fees or private transfer fee obligations. Alaska law incudes disclosure requirements for similar fees in the narrow context of a rental agreement between a mobile-home park operator and a mobile-home park tenant

In addition to PTF specific laws, many states have generally applicable real estate laws that may apply in the PTF context. For example, Minnesota law, Minn. Stat. § 500.20, generally limits the term of any long-term private covenant to 30 years. This limitation would also apply to PTFs. In all states, general real estate disclosure laws are an area that may have applicability to PTFs even though the statutes are not expressly limited to PTFs.

[2] Alabama, Arkansas, Delaware, Hawaii, Idaho, Illinois, Indiana, Maine, Nebraska, Nevada, New Jersey, New York, North Carolina, North Dakota, Oklahoma, South Dakota, and Tennessee.

[3] Alabama, California, Colorado Connecticut, Delaware, Kentucky, Louisiana, Maine, Minnesota, Nebraska, Nevada, New Jersey, New York, North Dakota, Pennsylvania, South Carolina, South Dakota, Texas, Utah, Washington, and Wyoming.

IMPACT ON REAL ESTATE/HOMEOWNERSHIP

Private transfer fees have a very serious impact on a number of aspects of real estate transactions and homeownership. Among others, they increase costs for consumers. Proponents of private transfer fees attempt to downplay the cost of transfer fees by focusing on the relatively small percentage of the price that the fees represent, usually 1%. However, when examples are used the true picture becomes clear. Take for example, a house being sold for $300,000 that has an enforceable 1% transfer fee. In this scenario, the seller is responsible for is $3,000. If the home appreciates and is next sold for $450,000, the fee jumps to $4,500. The fee must be paid even if the home decreased in value from the initial purchase, cutting into any equity gains from the sale or increasing the amount lost if the home depreciates under the price it was purchased for. Unfortunately, these fees are often buried in paperwork and many, if not most, homebuyers are unaware of them.

In addition to increased cost of real estate transactions for the individual buyers and sellers, PTFs create intertwined financing and title difficulties. As the American Land Title Association has explained in a public statement, the existence and use of PTFs increases the risks lenders and title companies are subject to when financing or insuring a property. Increased risk typically results in increased cost to consumers, or at worst, could result in unavailability of required services such as loans and title insurance to home purchasers.

The following illustration highlights the title and lending issues inherent in PTFs. In some cases, the PTF obligation is secured by a lien against the land subject to the PTF. Thus, if the PTF is not paid as required, the party owed the PTF will have a claim against the real property. Such a lien claim is of considerable concern to both title companies and lenders. Lenders require a “clean” title policy upon financing a purchase, which insures the first priority of its mortgage. A title company will be asked to insure that there is no lien interest currently held in the property by the party owed the fee. This may be easy early in the life of the PTF requirement, but can be more challenging twenty years down the line.

If the fee-owed party is unavailable to waive any right in the real property, someone will be required to accept the risk that the fee-owed party will show up in a few years requiring payment of the fee or threatening to exercise its interest in the property. The title company may be willing to accept this risk for a higher premium, ultimately resulting in a cost passed down to the consumer.

Finally, the very nature of PTFs create a risk of a host of legal issues for consumers in real estate transactions. Among other legal issues, PTFs might result in purchase agreement related challenges, allegations of breaches of the lending agreement’s terms, civil claims for failure to disclose or fraud or challenges to the validity of the PTF covenant itself. As a relatively new and still uncommon funding mechanism, PTFs and their impact on the legality of real estate transactions have not been fully tested in litigation. This creates risk for those involved in transactions with PTFs as any litigation can be time consuming and expensive for those involved.

It should be noted that NAR is opposed to PTFs, on the grounds that the fees decrease affordability, serve no public purpose, and provide no benefit to either property purchasers or the community in which the property is located. Deed restrictions imposing private real estate transfer fees also position affected properties at a disadvantage in the marketplace and may well undermine economic stability. Private transfer fees also pose a liability risk to REALTORS®, because the deed restrictions that impose the fees are often difficult to discover, and, therefore, disclose prior to a transaction.

REALTOR® ASSOCIATION INVOLVEMENT ON PTF ISSUES

Since 2010, NAR has consistently advocated against unfair private transfer fees and sought to raise public awareness of their existence and the negative impacts they have on the consumers and real estate related industry. Through direct advocacy, NAR and its state and local associations helped to turn the tide of legislation against private transfer fees.

One of the most illustrative examples of NAR's work on this issue is its role in the FHFA's adoption of the FHFA rule 12 CFR pt. 1228, discussed above. Among other actions, NAR sent numerous letters to the FHFA explaining the risks of PTFs and requesting FHFA adoption of a rule restricting Fannie Mae, Freddie Mac, and Federal Home Loan Banks from investing in private transfer fees. When the FHFA issued the regulation, NAR's role in getting the FHFA to pay attention to and issue the regulation regarding private transfer fees was so important that the FHFA pointed to its letters when it proposed the rule.

In addition to advocacy, NAR has consistently sought to ensure that its 1.5 million REALTORS® and consumers are aware of PTFs, know to look for and ask about them, and understand the implications of purchasing a home. NAR's educational efforts have included PTF White Papers, online resources on its website, legislative updates, and press releases.

COLLABORATION WITH OTHER ORGANIZATIONS

During the height of PTF growth, NAR partnered with other interested organizations to further turn up the volume on the voices against private transfer fees in most situations. The American Land Title Association ("ALTA") was a particularly close partner in advocacy efforts against private transfer fees. The Mortgage Bankers Association, Community Associations Institute, Institute of Real Estate Management National Association of Home Builders also played important roles in opposing private transfer fees and joined with NAR in advocating against them in letters to governing agencies.

CONCLUSION

Once a growing trend, private transfer fees have become heavily disfavored or outright prohibited under federal and state laws. Yet, PTFs are far from obsolete. PTFs added to properties when they were permissible have often been grandfathered in and upheld, certain types of PTFs are still permitted in many areas, and not all areas prohibit them from occurring in the future. REALTORS® representing buyers and sellers should become familiar with laws governing PTFs in their area and continue to ask about and look for PTFs when working on deals. Private transfer fees impact financing options and the evaluation of pricing in real estate deals and REALTORS® should keep their clients informed on how they may be impacted accordingly.

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Growth Management Fact Book: Analysis of issues related to land use and modern growth management topics include density — rate of growth, public facilities and infrastructure, protection of natural resources, preservation of community character, and affordable housing.

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