

FHFA ISSUES FINAL RULES ON TRANSFER FEE COVENANTS

On Friday, March 16, 2012, the Federal Housing Finance Agency ((FHFA) issued final rules regarding private transfer fees. The new rules, published in the Federal Register, limit the ability of the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac) to purchase mortgage loans on properties that are encumbered by certain types of transfer fee covenants, or to deal in secondary market securities related to those mortgage loans. The new rules do not directly outlaw transfer fees, but they will indirectly discourage the establishment of transfer fees in future development communities by making home loans in those communities difficult to obtain.

A transfer fee covenant is a contractual arrangement or covenant requiring the owner of real property to pay a fixed amount or a percentage of the sales price of the property each time the property is transferred to a new owner. A transfer fee covenant is designed to run with the land and to burden a property for either a set period of time, such as 99 years, or indefinitely. The most common use of transfer fees in California is by developers of large residential tracts as a means of funding the future cost of an ongoing mitigation measure—often environmental or conservation related—required by the State or local agency as a condition to approval of entitlements for the development. A transfer fee is most often paid to a 501(c)(3) charitable organization, either existing or formed by the developer, and can serve an important function in preserving wild life habitats, wetlands, recreational open space, and environmental sensitive areas for years to come. Opponents of private transfer fee covenants, however, question whether they truly serve a public purpose.

The FHFA has to a large degree sided with transfer fee opponents in promulgating its new rules. With some exceptions, Fannie Mae and Freddie Mac are now prohibited from purchasing, investing in or otherwise dealing in “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.” In addition, the twelve Federal Home Loan Banks overseen by FHFA are prohibited from accepting such mortgages or securities as collateral for loans to banks.

The final FHFA rules on transfer fees apply prospectively from the date FHFA first issued its proposed rules. Thus, they do not apply where either (i) the transfer fee covenants burdening the property were established before February 8, 2011, or (ii) the transfer fee covenants were created by an agreement entered into before February 8, 2011 (even though not recorded at that point), and the agreement was in settlement of litigation approved by a government agency or body. Further, FHFA responded to public comments by providing some limited exceptions. These exceptions include situations where a transfer fee is used to benefit a homeowners association or a charitable organization providing a direct benefit to the burdened property.¹ “Direct benefit,” however, is somewhat narrowly defined. The rules also do not apply where the transfer fees are payable to the Federal government or a State or local government.

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The new final FHFA rules effectively eliminate any secondary market for mortgage loans on properties burdened by non-exempt transfer fee covenants established after February 8, 2011. This may make transfer fee programs a less attractive alternative to developers faced with long term environmental or conservation mitigation requirements for their development projects. Any builder or land developer contemplating the establishment of a transfer fee covenant will need to employ careful planning and strategies to ensure that its fee program fits within an exemption to the FHFA rules, so that future homeowners are not prevented from obtaining home financing.

¹ It should be noted here that California law prohibits the imposition of transfer fees by an HOA except to cover the HOA's actual cost to change its records and to provide HOA information as requested by the buyer (California Civil Code Section 1368(b)).

Attorneys at Cox Castle & Nicholson have broad expertise in land use, residential development and finance, as well as significant experience in transfer fee programs established for many purposes, including wetlands and habitat preservation, recreational open space and environmental mitigation. For more information on transfer fee covenants and the new FHFA final rules, please contact:

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