

SUBJECT: Prohibiting certain private transfer fees and providing penalties

COMMITTEE: Business and Industry — committee substitute recommended

VOTE: 7 ayes — Deshotel, Orr, Bohac, Garza, Giddings, Quintanilla, Solomons
0 nays
2 absent — S. Miller, Workman

WITNESSES: For — Aaron Day, Texas Land Title Association; Randy Lee, Stewart Title Guaranty Co; Lori Levy, Texas Association of Realtors; John Rothermel, Stewart Title Guaranty Co (*Registered, but did not testify*); Mark Borskey, First American Title Co; J.E. Buster Brown, American Resort Development Association; Jennifer Brown, Mason Chase, LLC; John Fleming, Texas Mortgage Bankers; Richard Meyer, Texas Association of Nonprofit Organizations; Ned Munoz, Texas Association of Builders; Karen Neeley, Independent Bankers Association of Texas; Eric Sandberg Jr, Texas Bankers Association; Aaron Webb)

Against — Irene Adolph, Texas Homeowners for HOA Reform, Texas HOA Reform Coalition, HOADATA.ORG; Janet Admad, Home Owners for Better Building, HOA Reform Coalition; Jaime Arechiga; Pamela Bailey, Chaparral Management Co, AAMC; Greg Blume; Jamey Boyd; Jim Boyd; Rodrigo Carreon; Jason Delgado, Spectrum Association Management; Sandra Denton, Sienna Plantation Community Services Foundation; Tracy Donahue; Roy Hailey, Texas Community Association Advocates; Nancy Hentschel; Catherine Jensen, SCS Management Services; Bettie Jones, Crest Management Co., Vanmoor Property Socs.; Fred Shapiro, SBB Management Company, Texas Community Association Advocates; Darlene Sims, SCS Management; Michael Walker; Lynn Walshak, HOA Reform Coalition; Robert Wilson; Ken R. Winzen Sr., Providence Village HOA (*Registered, but did not testify*); Terri Allen, Longscreek HOA; Karla Anaya, Solana Ridge HOA; Pat Carlson, Texas Eagle Forum; Mark Castillo, Jessica Correa, Noe Christopher Correa, Longscreek HOA; Lourdes Correa, Matthew Correa, Noe Correa, Alfred Montoya, Las Lomas HOA; Bob Crawford, Park at Two Creeks HOA; Jacob Delgado, Hunters Chase Homeowners Association; John Elmore, Bluffs at Westchase H.O.A; Eric Franklin, Avery Park HOA;

Jason Gonzales, Park Place HOA; Mary Gurney, Cod Crest Property Owners Association; Andy Hill, Sierra Springs HOA; Lisa James, Solana Ridge HOA; Abigail Montoya, Las Lomas HOA; Susana Morales, Gardens at Greater Woodlake HOA; Chade Nelson, S.A. Creekside HOA, Inc.; Monica Ramon-Castillo, Longscreek HOA; Michael Smith, Villages of Westcreek HOA; Sally Smith, Deer Creek HOA; Susan Wachowski, Oak Bluff HOA; and 17 others representing themselves)

On — Teresa Grawe, The Lantana Education Charitable Foundation; Anthony Ruggeri, Richard Strauss, Republic Property Group

BACKGROUND: A private transfer fee obligation or covenant requires every owner after the original owner on each lot of a developer's subdivision to pay a transfer fee upon sale of the home, usually for the 99 years after the original sale. Generally, the fee required is equal to 1 percent of the purchase price of the home. The obligations specify that if an owner did not pay the fee, a lien could be placed on the property, which could lead to a foreclosure. A developer can choose to retain transfer fee rights and collect an allocated share of the fee during the term of the obligation or could choose to sell its transfer fee right to a third party.

Property Code, sec. 5.017 prohibits the buyer of a residential real property or the buyer's assigns from being required to pay a fee in connection with a future transfer of the property to a person imposing the deed restriction or covenant or a third party designated by a seller of the property. A deed restriction or covenant or a lien purporting to encumber the land to secure a right under such a requirement is void and unenforceable. A deed restriction or covenant may requires a fee associated with the conveyance of property payable to a property owners' association, a governmental entity, or a 501(c) organization under the Internal Revenue Code.

DIGEST: CSHB 8 would repeal Property Code, sec. 5.017. The bill would establish that a private transfer fee obligation was not binding or enforceable against a subsequent owner or purchaser and was void. It would define a private transfer fee obligation as an obligation to pay a private transfer fee created under a declaration or other covenant recorded in real property records in the county of the property, under a contractual agreement or promise, or under an unrecorded contractual agreement or promise.

A subsequent owner would be a person who acquired real property by transfer from a person other than the person who was the seller of the

property on the date the private transfer fee obligation was created. A subsequent purchaser would be a person who purchased real property from a person other than the person who was the seller on the date the private transfer fee obligation was created. It would include a lender who provided a mortgage loan to the subsequent purchaser to purchase the property.

Certain exemptions. The bill would exempt certain entities from a prohibition on private transfer fees by excluding from the definition of a private transfer fee obligation:

- consideration paid by a purchaser to a seller for an interest in real property transferred, including a mineral interest and any additional consideration paid to a seller for a property's appreciation, development, or sale after the interest in the property had been transferred to the purchaser, if the additional consideration were paid once and did not bind future buyers to any private transfer fee obligation;
- a commission paid to a licensed real estate broker under a written agreement between a seller or purchaser, including an additional commission for the property's appreciation, development, or sale after the interest in the property was transferred to the purchaser;
- interest, a fee, a charge, or another type of payment to a lender under a loan secured by a mortgage on the property, including a fee or charge paid for the lender's consent to an assumption of the loan or transfer of the property, for an estoppel letter or certificate, a shared appreciation interest or profit participation, or other considerations in connection with the loan;
- rent, reimbursement, a fee, a charge, or another type of payment to an owner under a lease, including a fee for consent to an assignment, sublease, encumbrance, or transfer of a lease;
- consideration paid to the holder of an option to purchase an interest in property, or to the holder of a right of first refusal or first offer to purchase an interest in property, for waiving, releasing, or not exercising the option or right when the property was transferred to another person; or
- a fee payable to or imposed by a governmental entity in connection with recording the transfer of the property.

Exemption for property owners' associations. The bill would establish an exemption for certain payments to a property owners' association,

including associations for timeshares, condominiums, and homes in incorporated and unincorporated areas. The bill would exempt dues, a fee, a charge, an assessment, a fine, a contribution, or another type of payment paid to a property owners' association from the definition of a private transfer fee obligation if the amount were under a declaration or other covenant or under law. The exemption would include a fee or charge to record the change of ownership in the association's records or for an estoppel letter or certificate issued by the association, provided that no portion of the fee or charge was required to pass through a third party designated or identifiable in the declaration or other covenant or law. The bill would exempt payments for the transfer of a club membership related to the property.

Exemption for 501(c) organizations. The bill would exempt dues, a fee, a charge, an assessment, a fine, a contribution, or another type of payment paid to a 501(c) organization, as defined by the Internal Revenue Code, if the organization used those payments to benefit directly the encumbered property by supporting, maintaining, constructing, or repairing improvements only to the property or by providing activities or infrastructure to support quality of life, including cultural, educational, charitable, recreational, environmental, and conservation activities and infrastructure. Encumbered property would be all property, including the property of a subsequent purchaser, subject to the same private transfer fee obligation.

A benefit could be made to an adjacent property or to a boundary no more than 1,000 yards from a boundary of the encumbered property. Benefits for which a fee was charged to the general public would be considered to benefit directly the encumbered property. The organization could provide activities and infrastructure to another 501(c) organization, as defined by the Internal Revenue Code, at no charge for minimal usage without violating the bill's requirements.

Notice of private transfer fee obligation. A person who would receive a private transfer fee under an obligation created before the effective date of the bill would, on or before January 31, 2012, be required to file a "notice of private transfer fee obligation" to be recorded in the property records of each county in which the property was located. Multiple payees of a single private transfer fee under a private transfer fee obligation would have to designate one payee as the payee of record for the fee.

The notice would have to be printed in at least 14-point boldface type and include:

- the amount and method of determination of the fee;
- the expiration date or circumstances under which it would expire;
- the purpose for which the fee would be used;
- each payee's name and contact information;
- the name and address of the payee of record to whom payment would be sent;
- the signature of each payee or payee's authorized representative; and
- the legal description of the property subject to the fee.

Requirement to re-file annually. A person required to file a notice would have to re-file on or before January 31 of each year in which a fee could be collected or received and amend the notice to reflect any change in the name or address of a payee within 30 days after the change occurred. A person amending the notice would have to include the recording information of the original notice and the legal description of the property subject to the fee.

If a person did not file the notice as required, payment of the fee could not prevent the sale of the property, which would no longer be subject to it, and the transfer fee obligation would be void.

Acceptance of payment. The payee of record on the date the private transfer fee was paid would be required to accept the payment on or before the 30th day after the date the payment was made. If the payee failed to pay by that date, the payment would have to be returned to the purchaser, payment of the fee could not be a requirement for the conveyance of the property to a purchaser, the property would not be subject to further obligation under the private transfer fee obligation, and the fee obligation would be void.

Disclosure in contract for sale. A seller of real property that could be subject to a private transfer fee obligation would have to provide written notice to a potential purchaser stating that obligation could be governed by the provisions of the bill.

A provision that purported to waive a purchaser's rights would be void.

A person who imposed or entered into an agreement imposing a private transfer fee obligation in the person's favor in violation of the bill's requirements would be liable for damages resulting from the imposition of the fee obligation, including the amount of any transfer fees paid and attorney's fees, expenses, and costs incurred in an action to recover the transfer fee amounts paid or to quiet title to the real property.

Penalties. The attorney general could institute an action for injunctive or declaratory relief to restrain a violation of the bill's requirements. The attorney general also could institute an action for civil penalties against a payee for a violation. A civil penalty assessed could not exceed two times the amount of the transfer fee charged or collected by the payee in violation of the bill's requirements. If a court found that a payee violated the requirements as a pattern or practice, the court could assess a civil penalty up to \$250,000. The comptroller would deposit the penalty amount into the General Revenue Fund.

Deceptive trade practices. A person would commit a false, misleading, or deceptive act or practice by violating the requirements of the bill.

Effective date. This bill would take immediate effect if finally passed by a two-thirds record vote of the membership of each house. Otherwise, it would take effect September 1, 2011.

SUPPORTERS
SAY:

CSHB 8 would prevent the deceptive practice obligating current and future owners of a property to a transfer fee prior to transferring the title upon sale. The bill would be sound public policy because it would protect all parties of a property sale or transfer, prevent the diversion of local tax bases, protect the alienation of title, and align state law with federal rulemaking. Any financial benefit created by a transfer fee obligation comes at the expense of Texas citizens.

Despite claims that the bill is unnecessary because Property Code, sec. 5.017 should be interpreted as a prohibition against transfer fees, a covenant is enforceable under the current statute because the terms obligate the seller to pay the fee, not the buyer. Current law prohibits the transferee, the buyer, from paying. Developers continue to impose transfer fee covenants upon residential land in Texas. The bill would remove any doubt about whether or not a private transfer fee obligation was permissible under the law.

Consumer protection. Private transfer fee obligations are detrimental to the housing market, including each buyer and seller, and benefit developers for many years after a subdivision is complete. If a property is sold 11 times during the 99-year term stated in the declaration, the developer or trustee collects a 1 percent fee from each seller in each transaction.

Opponents of CSHB 8 contend that consumers have adequate access to information and resources, but this is not true. The Financial Housing and Finance Agency, which has proposed a rule to prohibit federal involvement in mortgages with private transfer fee obligations, states in its proposals that buyers were not adequately informed about private transfer fees, which in turn affects the transferability of property and overall marketability.

Reducing unnecessary cost to buyers and sellers. The bill would prevent a buyer and a seller from incurring additional costs to negotiate the responsibility for payment of the private transfer fee obligation.

To negotiate the responsibility of the obligation, the seller of a property with a private transfer fee obligation often incurs additional costs to determine whether disclosure of the obligation is required and to ensure it is disclosed properly if required.

The buyer often spends additional time and money negotiating with the title insurer the form of the exception that the title insurer would take for the obligation. The buyer could incur greater expense to obtain financing if the lender required subordination of the transfer fee obligation lien, unless the obligation subordinated the developer's lien to the lien of future mortgages.

Under current law, the person charging the fee is not required to update information, which can render a thorough title search during a future sale of the property quite difficult.

Protect against the inability to "price" the effect of the fee. Opponents of the bill claim that because the covenant is recorded, a buyer would know to reduce its offer price to account for the fee obligation that the buyer would incur on resale. However, the buyer's ability to price the appropriate discount is based on expected future appreciation in the value and the appropriate rate used to convert the expected future transfer fee obligation into present dollars. There is little empirical evidence that

typical homebuyers are able to make informed or accurate judgments to plan for a future transfer fee.

Buyers lack perfect information about the length of time they would own the property. If a buyer expected to resell the property in two to three years, the buyer could appreciate the need to discount the offer price. A buyer who expected to hold the property for 40 years likely would disregard the need to discount the offer price. If the buyer expecting a long-term investment had to sell the property sooner, the buyer would not have been able to accurately price the appropriate discount for the transfer fee obligation.

If not given a choice of an unrestricted (not subject to the obligation) sale price and a restricted (subject to the obligation) sale price, the buyer would not have meaningful choice. Even if the buyer were given the option of an unrestricted sale price, the buyer would not have an identical baseline based on a similar or identical parcel of land by which to judge the burden or benefit of the obligation.

The amount of the buyer's future transfer fee obligation is a function of the land's value at a future date, and buyers lack perfect information about their holding periods.

Protect against the effect of an artificially decreased tax base. The bill would prevent a property owner from receiving higher than expected tax bills as a result of the artificially decreased sales price. When local governments appraise real property for taxation assessment purposes, they look to a number of factors to determine the tax rate. Tax assessors can compare a property with a covenant attached to a comparable property without it. Because the properties do not differ, other than the presence of the covenant, they are valued and taxed equally, resulting in a higher tax bill for property owners than the sale price would suggest.

Protect local tax bases. The bill would protect the tax base of communities whose properties had private transfer fee obligations. Some communities lose significant revenue due to the decreased tax collections caused by homeowners' attempts to compensate for private transfer fee obligations with lower than market value sales prices.

Through their study on the impact of private transfer fee obligations, the

Joint Editorial Board for Uniform Real Property Acts (JEBURPA) — made up of lawyers tasked with monitoring property codes — found that private transfer fee obligations reduce a community's tax base. If the sale price of a property is lowered to compensate for transfer fee obligations, the sale price no longer is an accurate representation of the property's fair market value or its taxable property value. When a sale price that does not reflect market value is used for tax assessment purposes, the property tax base for the community is lowered unnaturally. The consequence of this is that the difference in tax revenue goes to developers instead of the public schools, local infrastructure, and community services. To maintain services, governments must raise taxes or cut spending. The bill no longer would allow transfer fees to siphon money from valuable local services by decreasing the tax base.

Align state law with court holdings. The bill would align state law with judicial holdings across the nation — including state supreme courts in Massachusetts, Washington, and New Jersey — that private transfer fee obligations hinder the transfer of real property. These courts have held that in most cases the fee obligation represents a personal interest of the developer, which makes the obligation an unreasonable burden to alienation, the voluntary transfer of title for real property.

A private transfer fee is not paid to a property association but to private persons and does not benefit common facilities and amenities that in turn benefit the entire community. Often by the time a developer collects the first future transfer fee, the developer has completed the sale of all the lots affected by the private transfer fee obligation, thus having no legal interest aside from transfer rights in the community, making the benefit of the fee personal to the developer. Under common law, the burden of the covenant (obligation) does not run to bind successors to the original covenant. Some courts have held that the running of transfer fee covenants creates purely personal benefits to the developer, and therefore constitutes an unreasonable restraint on the transfer. The courts held that the potential burden warrants a per se rule prohibiting private transfer fee covenants (obligation) enforcement against successors.

Texas case law has established that a covenant running with the land must meet four criteria. The covenant must touch and concern the land. It must relate to a thing in existence or specifically bind the parties and their assigns and be intended to run with the land by the original parties who placed the covenant. Finally, the covenant must require that notice of the

covenant be given to the successors to the burden, which means that subsequent owners must be notified of the covenant. It is incumbent upon the Legislature to specify the parameters of this notification, which were not set forth by the court, by determining when and how notification must take place. CSHB 8 would require notifications and filings with specific content.

Opponents of the court holdings say that fees can be justified rationally, but case law and majority opinion disagree. The Federal Housing Finance Agency, which has proposed a rule to prohibit federal involvement in mortgages with private transfer fee obligations, states in its proposals that “the typical 1 percent is neither minimal nor reasonable” and not likely to be related to the value rendered by the property owner or community. The agency’s determination that these fees exist only to fund streams of income for select market participants and do not benefit the homeowner is congruent with the court’s holding that the developer’s interest in the transfer rights is purely personal.

Align state law with federal rules. The bill would align state law with soon-to-be federal rules. The rule proposed by the Federal Housing Finance Agency progressing through the federal rulemaking process would prohibit the Federal Mortgage Association, also known as Fannie Mae, the Federal Home Loan Mortgage Corporation, also known as Freddie Mac, and the Federal Home Loan Banks from dealing in mortgages on properties encumbered by private transfer fee covenants and related securities. The rule would except fees paid to homeowners associations, condominiums, cooperatives, and certain tax-exempt organizations that use the fee revenue to benefit the property owners directly. The rule would apply to covenants created on or after the date of publication of the rule. The agency said in its proposal that “such covenants are adverse to the liquidity and stability of the housing finance market, and to financial safety and soundness.”

The magnitude of the issue has risen to the level that the federal government would see the need to prohibit these financial institutions from involvement in a mortgage with a fee obligation. This should be a wakeup call to everyone.

Exemption for property owners associations. It is appropriate to provide the exemptions included in CSHB 8 because a transfer fee that is payable to a property owners association for the purpose of financing association

operations or maintenance of common amenities satisfies the “touch and concern” test. The bill would include provisions to prevent confusion by specifying that certain funds benefit the community directly and those in close proximity to the community’s boundaries. Currently, foundations use the fee to donate to charities of their personal preference that have no direct benefit on the community.

OPPONENTS
SAY:

CSHB 8 is based on the false assumption that private transfer fee obligations harm the market and the consumer. Purchasing property is a choice. If a buyer does not want to abide by a transfer fee obligation, the buyer may choose another property without an obligation.

Private transfer fee obligations are economic arrangements that spread the purchase price of property over time, allocate risk, and permit the sharing of profits from property development, all which benefit homeowners. If such arrangements are not unconscionable and do not otherwise violate public policy, there is no reason to deny parties—who are in a better position to ascertain the economic trade-offs—freedom of contract that would enable a transaction to go forward and enhance its overall value.

Consumer protection. The bill assumes that buyers do not have access to the information required to make an educated and rational decision, but buyers do have access to this information as well as the counsel of a lawyer or real estate agent.

Because the private transfer fee obligation is recorded, a buyer of an affected lot is privy to the information necessary to understand the way in which the buyer chooses to proceed, including whether or not to reduce the offering price given to the seller to account for the fee obligation that the buyer would incur on resale.

Cost to buyers and sellers. The discounted price afforded by the private transfer fee obligation benefits the buyer. Even a small decrease in the purchase price of a property would decrease the buyer’s acquisition costs, including the amount of financing necessary to purchase the property. Upon resale of the property the buyer’s brokerage commission would be reduced as a result of the purchase price that was decreased due to the private transfer obligation.

Protect against the effect of an artificially decreased tax base. The

decrease in the purchase price of the property would decrease marginally the annual ad valorem tax obligations because the initial sale price establishes the base value of the property for tax assessment purposes. Reductions in the purchase price of a property to compensate for private transfer fee obligations do not impact significantly the tax base of a community.

Protect the state's tax base. The fact that the possible value realized from a property was reduced does not justify legal intervention to nullify part or all of the arrangement.

Align with judicial proceedings. The judicial decisions from other states cited by the supporters of the bill could be challenged, as there are strong legal arguments to support private transfer fee obligations. Transfer fee obligations do not hinder alienation unreasonably and should be enforceable as long as the obligation has a rational justification. The 1 percent transfer fee obligation is justified because it benefits both the buyer and the developer. The developer benefits by retaining the transfer fee rights, which permits the sale of the developer's lots at a discounted price compared to land without transfer fee obligations. The buyer receives decreased acquisition costs.

OTHER
OPPONENTS
SAY:

CSHB 8 is unnecessary because Property Code, sec. 5.017 is sufficient to prohibit private transfer fee obligations. While supporters of the bill contend that a fee obligation is enforceable under the current law because covenants obligate the seller to pay the fee, not the buyer, it plausible to interpret sec. 5.017 as a prohibition upon transfer fee covenants based on a literal reading of the statute.

The bill should include a provision to invalidate any lien to the extent that it purports to secure the payment of a transfer fee. The provision was an element of the model statute suggested by JEBURPA.

NOTES:

The committee substitute differs from the bill as filed by including a provision about deceptive practices; defining encumbered property; including a requirement for a person who receives a private transfer fee to file the notice, whereas the bill as filed would have required the person who collected such a fee to file the notice; including a provision that would exclude certain property owners associations from the types of payments considered private transfer fee obligations; including a provision that would require payments to certain organization be used in a specific

manner; and requiring a seller to provide written notice to a potential purchaser.

The companion bill, SB 1459 by Harris, was referred to the Senate Business and Commerce Committee on March 22.