

FHFA Final Regulation on Private, Deed-Based Transfer Fees FAQ

Does CAI consider the final regulation to be “good” for community associations and association residents?

The original FHFA draft regulation would have “banned” all private, deed-based transfer fees by cutting off federally backed mortgages to any property with such fees. As nearly half of all community associations have such fees in place, the proposal would have had a devastating effect by rendering roughly 11 million homes in community associations unable to qualify for most mortgages.

The final regulation no longer poses a threat to homeownership in community associations and provides important protections for association residents. The final rule explicitly excludes any private, deed-based transfer fees in place prior to February 8, 2011, from FHFA regulation. Any traditional transfer fees adopted by a community association on or after February 8, 2011, should also be protected under the final regulation as “excepted transfer fee covenant”.

Importantly, the final regulation will protect association residents by ensuring that all funds generated from transfer fees are used to benefit their association and property. This new requirement in the federal regulation will stop a growing trend where transfer fees are paid to the original property developer and to investors who purchase rights to these developer transfer fees. Such transfer fees exclusively enrich other persons or businesses with no interest in the property or the homeowner. The final regulation stops this raid on homeowner equity and ensures that if a community association has adopted a transfer fee that the proceeds of the fee are used to directly benefit the property and community association.

How does the final regulation treat private, deed-based transfer fees charged by associations?

The final regulation establishes two important protections for private, deed-based transfer fees charged by associations. First, all association transfer fees in place before February 8, 2011, are NOT impacted by the regulation. Second, the regulation protects the rights of associations to adopt traditional transfer fees in the future.

Under the final regulation, all private, deed-based transfer fees created on or after February 8, 2011, must provide a “direct benefit” to properties encumbered by the fee. This standard, sometimes known as the burden v. benefit test, has been used by community associations over the past several decades when adopting transfer fees and is a well established, broadly accepted legal standard.

The regulation explicitly provides that private, deed-based transfer fees that directly benefit property are “excepted transfer fee covenants”. Most community association transfer fees are “excepted transfer fee covenants”. Only community associations that choose to deviate from this generally accepted industry and legal standard by adopting transfer fees that do not directly benefit properties will be impacted by the final regulation.

What is an “excepted transfer fee”?

Under the final regulation, an “excepted transfer fee” means:

“... [A] covenant that requires payment of a private transfer fee to a covered association and limits the use of such transfer fees exclusively to purposes which provide a direct benefit to the real property encumbered by the private transfer fee covenants.”

This means that if a community association charges a private, deed-based transfer fee and the fee is used for the exclusive and “direct benefit” of the property upon which it is levied, then the property will still qualify for federally backed mortgages.

How does FHFA define “direct benefit” for purposes of allowable private, deed-based transfer fees?

FHFA’s final regulation defines “direct benefit” as:

...the proceeds of a private transfer fee are used exclusively to support maintenance and improvement to encumbered properties, and acquisition, improvement, administration, and maintenance of property owned by the covered association of which the owners of the burdened property are members and used primarily for their benefit. Direct benefit also includes cultural, educational, charitable, recreational, environmental, conservation or other similar activities that—

(1) Are conducted in or protect the burdened community or adjacent or contiguous property, or

(2) Are conducted on other property that is used primarily by residents of the burdened community.

Under the “direct benefit” standard in the final regulation, transfer fees may be used to fund a wide range of traditional association services that directly benefit association residents and property. These services include governance, conservation, education, recreational, and other similar activities. These exceptions should permit transfer fees to fund the majority of association activities.

The final regulation permits association use of transfer fees to support all land that is owned by the association whether or not the property is adjacent to the association’s main property line or if it is located some distance from the association. However, these association properties (like all other association properties) must be primarily used by association residents. CAI does not interpret the final regulation to permit transfer fees to be used to support property that is generally open and available for public use or use by another entity, private or public.

What is a “covered association” for purposes of community association private, deed-based transfer fees?

FHFA defines a “covered association” as:

[A] nonprofit, mandatory membership organization comprising owners of homes, condominiums, cooperatives, manufactured homes or any interest in real property, created pursuant to a declaration, covenant or other applicable law; or an organization described in section 501(c)(3) or (c)(4) of the Internal Revenue Code. A covered association may include master and sub-associations, each of which is also a covered association.

CAI interprets this provision to apply to community associations, as well as charities and foundations that may be affiliated with such communities. This would mean that transfer fees charged by cultural, recreational or other charities/foundations within the community would not fall under the ban on mortgages contemplated by FHFA. However, any fees charged would be required to provide a “direct benefit” to the community and such benefits must flow to association residents and property. This means any funds benefiting property within the community itself would be allowed, as would fees that go to property owned by the association. Any transfer fee adopted on or after February 8, 2011, beyond these parameters would likely disqualify an association from federally backed mortgage financing.

Were specific changes made to the final regulation sought by CAI?

CAI flagged several important concerns with prior versions of FHFA’s private transfer fee regulation. These concerns and changes to the final regulation include:

The Definition of “Adjacent or Contiguous Property”

CAI strongly objected to the original definition of “adjacent or contiguous property” which would have limited the use of association funds to only those association properties within 1,000 yards of the association’s main property line. CAI viewed this standard as arbitrary and dismissive of the diversity of community associations. CAI noted the standard would prevent community associations from using all association income to support all property owned by the association. Further, CAI noted the 1,000 yard standard did not take into account the master association/sub-association structure within community associations.

FHFA substantially revised its position, eliminating all references to the 1,000 yard limitation in the definition of “adjacent and contiguous property”. FHFA also revised the final rule to permit associations to use funds from transfer fees to benefit all property owned by the association, irrespective of its proximity to the property line of the association.

The Definition of “Covered Association”

To ensure that all community associations would meet the definition of “covered association,” and thus the exemption on the transfer fee “ban,” CAI urged FHFA to adopt the definition of community association as developed by the National Conference of Commissioners on Uniform State Laws in the Uniform Common Interest Ownership Act (UCIOA). While FHFA did not opt to use the UCIOA definition of community association, FHFA did revise the final regulation to recognize community associations that are organized under the master association/sub-association model. This is an important revision as it ensures that all association structures are protected under the final regulation.

The Definition of “Direct Benefit”

CAI identified three major concerns in FHFA’s proposed definition of “direct benefit”. These concerns were:

- 1) The definition could prevent community associations from serving the general public.
- 2) The definition could restrict the use of community transfer fees by community associations.

- 3) The definition degraded the private property rights of residents in common interest communities by limiting their exclusive right to govern the use of common property or common elements.

Property Access

As originally drafted, FHFA sought to limit public use and access of association-owned land “only upon payment of a fee” with associations allowed to provide free access to charitable or non-profit organizations on a minimal basis. CAI expressed concerns that the restrictions in the proposed rule could alter public access to certain association common property. CAI stated that association residents, acting through the association, exclusively reserve the right to provide access to association property subject to applicable Federal and state law.

FHFA addressed CAI’s concerns by deleting all references to the ability of the public to access association common property “only upon payment of a fee” or mandating free use of association common property by select organizations. FHFA also adopted CAI’s position that an association is free to allow access to common property as long as such access provides a direct benefit to the encumbered properties.

Use of Funds Generated by Transfer Fees

As originally drafted, FHFA permitted the use of transfer fee proceeds for maintenance and improvements to common property, thereby potentially excluding a number of common association services. FHFA addressed CAI’s concerns by ensuring that transfer fees can be used to support association services, including acquisition, administration, and maintenance of property owned by the association.

Private Property Rights of Association Residents

CAI strongly objected to any restriction on a community association’s authority to determine use of and access to common property as a substantial degradation of association homeowner private property rights. By deleting language in the rule that could be construed as requiring non-association residents to pay a fee to access common property or requiring associations to provide certain charitable organizations free access to common property, FHFA has recognized the right of association residents to control access to association property.

CAI is strongly committed to the principle that association residents are best suited to make determinations on the use of common property. Any action by the federal or state governments to limit the ability of association residents to control use of and access to common property is a significant degradation of established concepts in private property law. Ownership in an association by no means degrades these rights.

Now that FHFA has issued a final regulation, what happens next?

The Federal Housing Finance Agency (FHFA) published its final regulation on private transfer fees in the *Federal Register* on March 16th. The regulation allows a 120 day period from this date before the regulation becomes effective.

Under the regulation, Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System are responsible for implementing their own policies to ensure they do not purchase or otherwise fund mortgages for properties with non-excepted transfer fees. CAI will work with these organizations and with lenders to ensure the regulation is implemented in a manner that protects community associations. A particular focus of this work will involve determining which among the relevant parties (community associations, Fannie Mae, Freddie Mac, the Home Loan Banks, title insurers, and mortgage lenders) will issue a finding that a transfer fee covenant meets the “excepted transfer fee covenant” standard.

Does my association need to do anything right now?

If your association’s private transfer fee was effective **BEFORE** February 8, 2011, your association will **NOT** be impacted by FHFA’s rule.

If your association adopted a private transfer fee on or after February 8, 2011, you must ensure that transfer fee proceeds are used for purposes that meet the requirements of FHFA’s regulation. Most association transfer fees will not be impacted by FHFA’s regulation. Your association may wish to seek a review of any transfer fee covenant that was adopted on or after February 8, 2011, to ensure compliance with FHFA’s regulation.