Private Transfer Fee Covenants and Their Consequences for Real Property

February 2010

Introduction

Private Transfer Fee (PTF) covenants are being placed on real estate at an expanding rate. These covenants require that consumers pay a fee to a builder, developer or other party before a property can be transferred between owners during a sale. It is not entirely clear how these covenants affect consumers, but there is a strong potential for a negative effect on consumers, how ownership rights are determined, how real estate is valued and transferred legally, safely and efficiently.

Complications are likely to arise when these covenants are discovered during the title record search and real estate settlement or closing, which could very possibly delay or even cancel the sale of real property. If a covenant of this type is discovered, land title professionals will be required to obtain documentation from individuals not associated with the sale or the property. In addition to these concerns, it is not at all clear that these fees and covenants are even legally enforceable. Without clear guidance on the legality of PTF covenants, there is an increased and unnecessary risk regarding transactions on properties with these covenants attached. Litigation related to these covenants is likely to restrict the transfer of real property between parties even further.

A relatively new practice, PTF covenants have only recently shown up in land title records and thus state legislatures have not fully debated the unintended consequences of these covenants. However, in the six states that have considered PTF covenants, all have curtailed their usage in some manner.

This paper examines PTF covenants, how they operate, their history, and possible unintended consequences in order to provide information necessary to make an informed decision on the role PTF covenants should play in real property transfers.

Private Transfer Fee Covenants – How do they work?

A PTF covenant is a transfer fee payable to a private third party (typically the property's Developer or their trustee), upon each sale of the property between a buyer and a seller. The Developer establishes the PTF covenant by either recording a covenant in the local public record or including the covenant in the deed for each home in a planned subdivision. Typically, these covenants are in effect for 99 years and are applied to residential properties.

In the most widely promoted version of this arrangement, a Developer obtains licensed documents and advice on creating PTF covenants from a licensing company in exchange for a percentage of the transfer fees. The covenant requires that at each sale of each parcel of property (for up to 99 years,) a consumer, either the buyer or seller are required to pay a transfer fee to the Developer. The transfer fee is usually a percentage of the final sale price (typically 1%) and is usually collected by a trustee.

Typically, the trustee takes a portion of the 1% fee for expenses and distributes the remainder to the developer, the licensing company, and sometimes other parties who also have no ownership interest in the property. If a consumer does not pay the PTF covenant, a lien is established against the property in the amount of the unpaid fee, plus interest. Before the property can be sold or refinanced, that lien must be satisfied or the property will be unmarketable.

Under the arrangement the PTF covenant is split between the licensing company (30%), Developer (60%) and the real estate broker (10%) for the first 30 years it is in effect. For the remaining 69 years, the PTF covenant is split between the licensing company (90%) and real estate broker (10%).

To illustrate this system, consider a new-construction real estate development called Ocean View. The developer of Ocean View records a covenant on each parcel of property in the Ocean View subdivision. The covenant requires that upon resale of each piece of property in the development the consumer pay the trustee for the developer a fee of 1% of the sale price.

In many cases, the developer might lower the initial sale price by 2% and exempt the first purchase from the requirements of the covenant. This helps to camouflage the covenant and its requirements by suggesting the covenant is a benefit to the consumer, thus assisting the developer to initially sell the property. When the initial owner sells the property to buyer #2 for $250,000, the terms of the covenant require that the seller (initial buyer) pay the developer a PTF covenant in the amount of $2,500. The initial owner may either pay the PTF covenant, challenge its legality in court (thus clouding the property's title and preventing its sale) or buy out the covenant according to the terms of the covenant. Regardless, the owner will be required to pay more money for the ability to sell *their* real property.

This scenario would play out again when owner #2 makes improvements and then sells to buyer #3 for $350,000, generating a $3,500 PTF covenant and continue until the covenant expires after 99 years.

Securitizing Private Transfer Fee Covenants

In an emerging scheme, a PTF covenant licensing company markets PTF covenants as an investment vehicle. The company intends to "bundle" PTF covenants so that they can be securitized and resold on the open market in order for developers to more quickly monetize these streams of revenue. To do this, the Developer pays the licensing company a commission in exchange to create a financial security (essentially a collateralized bond) in the amount of the estimated value of the future revenues that are expected to be generated by the PTF covenant. In return for creating the covenants underlying the value of the securities, the Developer is provided with an upfront payment.

Bundled PTF covenants have not yet been securitized, however if this does occur and a credible securitization market is established, then the use of PTF covenants will increase exponentially and the incentive for developers to place these covenants onto properties will likewise increase. Estimates are that over $520 billion worth of real estate have already had PTF covenants attached which have the potential to create $50 billion pool of PTF covenant securities.

PTF Covenants for Homeowners' Associations or Charitable Organizations

PTF covenants or portions of the proceeds from PTF covenants have been used to fund a variety of programs where a benefit to homeowners, consumers and the community at large can be more easily identified. These PTF covenants increase the value of the consumers' property by make their home or community a more desirable place to live, and consumers often seek out these added benefits when purchasing a home. In these instances, the buyer pays the PTF covenant and proceeds are payable to homeowners' associations, environmental groups or other charitable organizations. These organizations then use the fees to fund projects which benefit the property from which the PTF covenant derives or the surrounding community, either directly or indirectly.

In cases where PTF covenants are used to help fund homeowners' association activities, the PTF covenants are a source of revenue to assist associations provide services to the homeowners they represent, much like yearly association dues. The PTF covenant is paid by the buyer at closing, and then used by the homeowners' association for maintenance, administrative costs or capital improvements. The benefits of these fees flow through the association and back to the consumer in the form of higher property values from community improvements, lower association dues and generally more desirable communities.

Some developers are using transfer fees to fund community organizations like community centers, performing arts centers or parks. In these communities, the Developer builds the community center and then transfers ownership of the center to a properly established non-profit 501(c)(3) organization. The transfer fees then go to the non-profit 501(c)(3) organization to help funds its mission. These PTF covenants also helps provide desirable services to the consumer and community, and makes the consumers home more valuable because of those services.

In California, PTF covenants have been used as tools to ease environmental concerns posed by groups opposed to new construction development. In these cases, the transfer fee is used to provide a service or fund organizations that are generally recognized as positive influences the community, such as open space preservation, environmental offsets, or clean water mitigation. The services funded through these transfer fees help reduce taxes and other costs while providing beneficial services to the consumer and the community.

One of the first reported PTF covenants was created to meet the demands of the Sierra Club and Audubon Society for environmental protections during the development of Fiddyment Farm in Roseville, California[1]. The Fiddyment Farm development imposed a 20-year PTF covenant with the proceeds going to preservation of open spaces.

PTF covenants have also been used as tools to ease affordable housing concerns posed by groups opposed to new construction development or for grants to support local affordable housing initiatives. Companies such as Lennar Corporation have used PTF covenants on some of its property as a way to fund its charitable foundation, the Lennar Charitable Housing Foundation ("LCHF")[2]. LCHF uses the funds to issue grants to local non profits to provide affordable housing throughout the states of Lennar's operations. Although Lennar originally only used PTF covenants in California, the company has started to use them in developments in Arizona and New Mexico as well.[3]

Unlike other forms of PTF covenants, transfer fees flowing to homeowners' associations, environmental uses or other non-profit organizations help fund important services in the community that benefit the consumer. PTF covenants that only benefit an individual Developer, company or similar third party do not provide any useful services to the community at large or the consumer. Rather, they steal equity away from consumers. Lastly, unlike other forms of PTF covenants, those that benefit homeowners' associations or other charitable organizations are legally enforceable according to common law which requires that covenants must "run with the land."

Brief History of the Private Transfer Fee Covenants

PTF covenants are a relatively new occurrence originating in California and Texas over the last decade. As indicated above, one of the first reported PTF covenants was created to meet the demands of the Sierra Club and Audubon Society for environmental protections during the development of Fiddyment Farm in Roseville, California, which imposed a 20-year PTF covenant with the proceeds going to preservation of open spaces.

A Texas company Freehold Licensing, Inc. ("Freehold"), has advertised a licensed PTF covenant system, and claims that they are awaiting a business method patent. The company purports to be attempting to securitize and monetize PTF covenants as well.

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1 See Kelly Quigley, Front Lines: Private Transfer Taxes, Realtor Magazine (September 1, 2007). Available at http://www.realtor.org/archives/frontlinesledesep07?presentationtemplate=rmo-design/pt_articlepage_migratedcontent_print&presentationtemplateid=06ad608049e7ba93ab3dab87f8d337ee.

[2] See Carl Larson, *Helping The Homeless Added To Cost Of Homes*, The San Diego Union Tribune (April 14, 2005). Available at http://legacy.signonsandiego.com/uniontrib/20050414/news_1n14lennar.html.

[3]See Jeff Collins, *Lennar's Charitable Fund Raising Opposed*, Orange County Register (May 14, 2007). Available at http://www.ocregister.com/articles/lennar-8458-fee-private.html.

In addition, sporadic activity regarding PTF covenants has been reported in states such as Colorado, Utah and Virginia. It has been reported that real estate projects in 45 states have been developed with PTF covenants attached to them.

UNINTENDED CONSEQUENCES FOR CONSUMERS

PTF covenants require consumers pay more for a less secure land transfer system and provide no added benefit to consumers. They harm consumers by stealing equity from their home, increasing the cost of buying or selling real estate and reducing the marketability of their property by making it more difficult to transfer real property. Even further, they reduce transparency for consumers by exploiting the complexity of real estate transactions.

Private Transfer Fee Covenants Steal Equity from Consumers

Contrary to the assertions of PTF covenant proponents that argue PTF covenants save consumers money, PTF covenants steal equity from homeowners.

If the PTF covenant is to be paid by the property's owner, when the homeowner seeks to sell their home, the PTF covenant requires them to pay a third party for the right to sell their own home. These covenants require that homeowners pay a portion of the equity they built in their home to a third party who has no ownership interest in the property and did nothing to assist in the maintenance or improvement of the property during the time of the consumer's ownership of the property. In essence, PTF covenants are private taxes that benefit third parties with no right to the revenue. The net result is that sellers earn *less* money on their most important investment. PTF covenants are a method for transferring home equity from its rightful owner to a third party.

Some argue that PTF covenants allow the property's developer share in the appreciation in property values which are attributable to the developer's role in designing and building the community. They argue that this allows developers to more fairly distribute the costs of building a home to all of those owners that benefit from its construction. The reality is that PTF covenants are not tied to any increase in property values that can be attributed to the developer or to any specific costs that are incurred by the developer. Consumers are forced to pay a PTF covenant every time the property is sold, even if there is no appreciation in values and the property is sold at a loss.

Private Transfer Fee Covenants Cost Consumers Money

Proponents of PTF covenants claim that the main benefit to consumers is a lower sales price and therefore lower cost of homeownership for consumers. They argue that when developers place a PTF covenant on a property, they lower the initial purchase price of the property by 2%. This sale price reduction results in the buyer having to finance a smaller mortgage thus saving money on the mortgage principal, interest, insurance premiums and other closing costs. However, if the buyer is forced to pay the PTF covenant, their out of pocket closing costs, which cannot be financed, will increase by 1% of the total sale price in order to

pay the required PTF covenant. It is also possible, that due to an increased risk of an unpaid PTF covenant placing a lien or title claim on the property, lenders may even require buyers to make a higher down payment or deposit more money in escrow on a property which has a PTF covenant attached to it.

Private Transfer Fee Covenants Depress Home Prices

Additional unintended consequences result from a developer artificially lowering the initial purchase price of the property by 2%. To support the claim that PTF covenant benefit consumers by lowering the initial sale price, proponents assert that, "a buyer buying property encumbered by a 1% fee will always pay less than he would have otherwise paid."

We can see the effects of a PTF covenant on a property when we consider a situation where there are two identical properties: one with a PTF covenant attached and one without a PTF covenant attached. Assume an average resale rate of 7 years, and an annual average appreciation rate of 1.7% compounded annually for each property.

	Initial Value	Sale 1 (7 years)	Sale 2 (14 years)	Sale 3 (21 years)	Total
Non-PTF Property Sale Price	$250,000.00	$281,310.98	$316,543.46	$356,188.60	
PTF Property Sale Price	$245,000.00	$275,684.76	$310,212.59	$349,064.83	
PTF Paid by Consumer	$0.00	$2,756.85	$3,102.13	$3,490.65	$9,349.62
Lost Appreciation	$0.00	$626.22	$704.65	$792.90	$2,123.77
Total Cost to the Consumer	$0.00	$3,383.07	$3,806.78	$4,283.55	$11,473.39

When the property with a PTF covenant attached is sold for $245,000 – a 2% discount – the initial sale price is depressed by $5,000. However, the appreciation in the property's value is also depressed, resulting in consumers purchasing a property with a PTF covenant attached earning less return on investment in the property than consumers purchasing a property without a PTF covenant attached. Overall, the first four owners of a property with a PTF covenant attached lose $2,124 in value and must pay $9,350 in fees.

Private Transfer Fee Covenants Have No Positive Effect on Consumers' Property Tax Liability

While a property's sale price is a major measure of a property's value, it is not the only factor used to determine the value. When local governments appraise real property for taxation purposes, they look to a number of factors to determine the tax rate. The taxing authority will compare a property with a PTF covenant attached to a recently-sold comparable property that does not have a PTF covenant attached. This results in the property with a PTF covenant

attached being appraised at a similar value as a non-PTF covenant home, negating any perceived decrease in the property's value.

One of the largest barriers to homeownership is high out-of-pocket closing costs. Higher sale prices are not a barrier to homeownership. PTF covenant proponents attempt to solve a problem which does not exist. However, any charges that could increase the amount of out of pocket money that buyers must bring to closing will depress home sales and prevent consumers from recognizing the American dream.

Private Transfer Fee Covenants Increase Procyclicality of Real Estate Markets

Real estate is a procyclical investment, which means that property values and sales rise and fall with the overall economy. Some describe this as a boom and bust market cycle, and it is marked by volatility in prices. PTF covenants accentuate the procyclicality of the housing market by affecting the incentives for consumers to purchase property during the up and down periods of the market cycle.

During an up market, consumers will have less incentive to understand PTF covenants attached to property they purchase and their effects, allowing for these properties to likely sell more quickly and at a higher price than they would sell during a down market. In peak markets, PTF covenants and their impact on real estate are effectively hidden from consumers.

However, during a down market, when it is already more difficult to transfer property, PTF covenants create an additional disincentive for consumers to sell or even purchase property with these covenants attached, and make property all the more difficult for consumers to buy or sell. In trough markets, PTF covenants are acutely known by consumers, because they increase the costs of owning the real estate.

Private Transfer Fee Covenants Reduce Transparency and Exploit the Complexity of Real Estate Transactions

The PTF covenant system is opaque and confusing for consumers. Even if PTF covenants were as beneficial to consumers as proponents claim, those benefits are hidden behind a lack of choice and the veil of legal documents. Supposedly, consumers benefit from PTF covenants because in exchange of the future transfer fees, the original developer can sell the property at a discount. However, consumers are not allowed the choice to decide if they want a property with a PTF covenant attached or not.

Consumers cannot shop comparable properties to determine if a PTF covenant is beneficial. There is no choice available to select a home with a PTF covenant attached at a slightly lower price or select a home without a PTF covenant attached at market price. The buyer cannot actually calculate and compare any savings. Without the choice, consumers also

cannot be certain that the sale price of the property is actually being discounted. The ability to shop and compare is essential for consumers when purchasing a home and an informed decision rests on consumers' ability to compare prices and services.

Home buying is an already a difficult, time consuming and confusing process, and PTF covenants make it more confusing for consumers. The process of buying a home is a unique experience for most consumers, and is often the only time that they come in contact with the terms of real property law and mortgage liens. These concepts can be difficult for consumers to grasp and the complexity of PTF covenants add further, unnecessary confusion.

Further, PTF covenants are discovered at a time in the real estate closing process when a transaction is being completed, giving a consumer a disincentive to delay the process in order to make an informed decision regarding the effect of a PTF covenant on the property. A prior placed PTF covenant may not come to the attention of the buyer until after a title search is conducted and just before closing. Often, these extremely complex concepts will have to be explained to the consumer right before closing, when they have the least incentive to walk away from the deal.

Finally, PTF covenants are not written in plain language, and can often be difficult for even experienced professionals to comprehend, much less explain accurately to consumers.

How Real Property is Transferred

The land title industry consists of thousands of title insurance agents and abstracters, underwriters, real estate settlement service providers, and attorneys who work together to ensure that real estate is safely, efficiently and legally transferred by searching, reviewing and insuring land titles to protect home buyers and mortgage lenders who invest in real estate.

Land title professionals assist consumers in the purchase of real property by scouring public records to establish legal ownership of the property being sold, curing any title or public record defects (one third of all transactions reveal a defect), accounting for and transferring all money related to the sale and insuring the transaction against any mistakes, fraud, risk or defect, whether it is known or unknown. The net result is a system that provides consumers and lenders the fastest loan closure and title transfer in the world. The land title system in the United States works so well that most consumers never take the opportunity to learn how or why it works.

This work ensures that buyers are willing to purchase property and lenders are willing to make loans. Unlike other forms of insurance, which accept that risk will occur and focus resources on paying claims, title insurance seeks to protect consumers by identifying and eliminating risk in order to prevent consumers from being harmed.

UNINTENDED CONSEQUENCES FOR THE TRANSFER OF REAL PROPERTY

In addition to these serious concerns for consumers, PTF covenants harm economic growth by hindering the legal, secure and efficient transfer of property. Discovery of a PTF covenant during a title search and real estate settlement process adds time required to close a transaction and may result in a cloud on a property's title, reducing the efficiency of the real estate transfer system.

PTF covenants introduce unnecessary risk into the land transfer process. These encumbrances cloud title and make the transfer of real property more costly and less certain. PTF covenants create risk in the settlement of home sales in three key ways: 1) by creating lien issues for lenders, 2) by increasing the risk of title claims and 3) by risking the legality of the property transfer itself.

Private Transfer Fee Covenants Create Lien Issues for Lenders

Before a lender can lend money, it must secure the debt. To do this, the lender requires that it be in the first lien position. A consumer's failure to pay a PTF covenant constitutes a lien against the property which must be paid before a new mortgage can be issued on the property. When a prior PTF covenant is unpaid, that puts the PTF covenant beneficiary in the first lien position ahead of the lender.

If a prior unpaid PTF covenant is discovered, it could place the consumer in technical default of their mortgage. The presence of PTF covenants creates a gap in the lenders security interest making a mortgage on a PTF covenant property more risky and likely more costly. PTF covenants remove the assurance lenders have that they will have the first right to the real property in the event of default. This heightened risk to the lenders' security interest could pressure them to tighten lending standards or require the consumer to bring even more out-of-pocket money to the closing.

It is very possible that PTF covenant properties could become unmarketable. If the risks associated with PTF covenant properties became so great for lenders that it prevents consumers from purchasing a PTF covenant property because no lender would lend money on a property that has a PTF covenant attached to it. This would result in the property becoming unmarketable, leaving a consumer with two unacceptable and unfair options, 1) begging the PTF covenant beneficiary to release the PTF covenant or 2) buying out the PTF covenant beneficiary's rights at an extraordinary cost. If the PTF covenant were securitized, the consumer would be left with the herculean task of getting thousands of securities holders to grant releases from the covenant just so an owner can sell their property.

Private Transfer Fee Covenants Increase the Risk of Title Claims

PTF covenants increase the risk of loss on a title insurance policy. The long time frame of these covenants makes it more likely that there will be a defect in the record as to payment of

the PTF covenant or discharge of the PTF covenant which could be undiscovered in a title search.

When a title insurance policy is purchased, the title company is asked to insure that there are no outstanding liens against a piece of real property may have trouble determining whether all PTF covenants have been paid throughout the life of the covenant. To keep costs to consumers down, most title searches do not go back 99 years, however a title search on a PTF covenant property would require a 99-year search. Further, the long time frame will make it more likely that the parties that need to be contacted in order to cure a title defect cannot be found due to death or dissolution.

Private Transfer Fee Covenants May Not Be Legal

In property law, alienation is the ability for property to be sold or transferred from one party to another. The ultimate property right is fee simple title, and the hallmark of fee simple title is the ability for an owner to transfer the property at their will, or alienation. Although property may be subject to restraints on alienation, PTF covenants erode fee simple title, and therefore courts are likely to find PTF covenants as an unreasonable and impermissible restraint on alienation.

In addition, the existence of a PTF covenant could be interpreted as a failure to grant the proper estate as required by the purchase agreement and deed. A seller that promises to grant fee simple title but insists upon a PTF covenant could be in breach of the purchase agreement and the warranties they provided in the deed. Further, a reservation of a PTF covenant in a deed granting fee simple title may violate the standard instructions from the consumer's lender regarding acceptable exceptions to title.

Legal tests have shown similar restraints on alienation to be illegal. Several state courts found a due-on-sale clause promulgated by mortgage lenders in the 1970s to be unreasonable and therefore an invalid restraint on alienation, since they had no business purpose except to increase the lender's return on investment.

PTF covenants may also be subject to legal challenge as a non-possessory interest. Courts have been generally unwilling to recognize or create new interests in land. Traditionally, the hallmark of all acceptable interests in land is that the holder of the interests may either at present or in the future physically possess the land. If PTF covenant rights are viewed as an attempt to retain some part of title without having any right to present or future possession, courts will be hesitant to allow these rights to exist.

Covenants are legally enforceable agreements granting the right to use property without possession or the right to preclude a possessory owner from using their property in certain manner. While similar to a contract, a covenant differs because the covenant has the power to bind future owners or "run with the land." Since covenants have a great power to bind future

entities not party to the original negotiations, courts have limited the situations in which these covenants can "run" with the land.

Touch and Concern Test

Common law requires a number of factors for a covenant to bind a successor, but the most important is that the benefit and burden of the covenant must touch and concern the land[4]. The touch and concern test, while hard to define, has been summarized as requiring that the covenant must affect the owner's physical enjoyment of the land.[5] This standard for touch and concern requires that the benefit and the burden of the covenant not be personal to the parties, but rather be intimately tied to their physical use of their property.

The key to the touch and concern test is the nature of the benefit or burden. Traditionally when the benefit and burden are payments of money, courts have held that the covenant is personal and does not touch and concern the land. There are extremely limited exceptions to this rule which generally benefit homeowners' associations.

To illustrate this point, consider a covenant requiring all homeowners in a development to only use a certain contractor for home improvements. Under this scenario, the benefit is personal to the contractor since it benefits their business interests and not any property interest. It does not help the contractor use their land but rather makes their business more profitable. Almost all covenants for the payment of money are personal to the beneficiary and therefore they do not touch and concern the land. The weight of judicial opinion prevents covenants from binding successive owners when the benefit is personal[6].

Contrast this with the homeowner's association scenario where all home owners covenant to pay a fee to a homeowners association. This covenant would likely bind future owners of the property in this division because the homeowners association's activities affect the property owner's physical enjoyment of the land. The benefit and the burden of the covenant touch and concern the land because as a badge of land ownership, the homeowners are burdened with the payment but they also benefit from the associations activities and requirements[7]. It is widely regarded that homeowners associations increase the value of property, and benefit all the owners. Therefore the benefit and the burden are tied to the physical enjoyment of all the homeowners' lands.

Typically PTF covenants are payable to a third party that is not a homeowners' association. The payment of the PTF covenant benefits the third party's business interests.

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[4] The other elements are 1) the intent of the parties that the servitude bind future owners, 2) a writing sufficient to appease the statute of frauds, and 3) privity of estate

[5] See *Mercantile-Safe Deposit & Trust Co. v. Mayor & City Council*, 308 Md. 627, 521 A.2d 734 (1987).

[6] *See, e.g., Garland v. Rosenshein*, 649 N.E.2d 75 (Mass. 1995); *Bremmeyer Excavating, Inc. v. McKenna*, 44 Wash. App. 267, 721 P.2d 567 (1986); *Caullett v. Stanley Stilwell & Sons, Inc.*, 67 N.J. Super. 111, 170 A.2d 52 (1961).

[7] See the landmark case *Neponsit Property Owners' Ass'n, Inc. v Emigrant Indus. Sav. Bank*, 278 N.Y. 248, 15 N.E.2d 793 (1938).

Further, when the first transfer fee is owed, the third party has usually sold their interest in the development and has no more legal interest in any property in the development (outside the interest in the PTF covenant). Therefore, the benefit of the PTF covenant is personal to the third party since it is not intimately tied to their enjoyment of the land in the development but is rather tied to their business interests.

Difficulties in working with an amorphous concept like the touch and concern test has led legal academia to rethink their approach to covenants. The American Law Institute's *Restatement (Third) of Property: Servitudes*[8] abandons the touch and concern test for an inquiry into whether the covenant is "arbitrary, spiteful, capricious[9]" or an "unreasonable restraint on alienation[10]" or "unconscionable[11]". Professor Susan French, the Restatement's Reporter, suggested that the most important inquiry is whether the covenant violates public policy[12]. Further, she suggested the Restatement's goal is to reach the same conclusions as a court using the touch and concern test, but with great transparency of thought.

State Legislative Response

Currently all six states which have passed legislation on PTF covenants have limited their usage in some way. Since 2008, four states (Florida, Missouri, Kansas and Oregon) have enacted statutory prohibitions on PTF covenants, and more states are expected to follow. In California and Texas (where PTF covenants are more often used) legislatures have restricted the creation and enforcement of PTF covenants.

California passed a PTF covenant law in 2007. California Civil Code § 1098.5 struck a balance between the California Association of Realtors, who sought a total ban and the California Building Industry Association and environmental groups who sought to keep PTF covenants legal. The law requires explicit disclosure of the PTF covenant to all concerned parties by the placement of a document in conspicuous font indicating, "Payment of Transfer Fee Required" in the public record. California's disclosure rule mandates: 1) a clear statement regarding the fee amount, 2) examples of actual cost, 3) the covenants expiration date, 4) the PTF covenants purpose and 5) the name of the entity to be paid. The goal of this law is to provide the homebuyer with information necessary to make an informed purchase.

Texas passed a PTF covenant law in 2007 at the behest of the Texas Association of Realtors. Texas Property Code § 5.017(b) prohibits covenants that require the buyer of real

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[8] The American Law Institute's restatements are a serious of compilation of the generally accepted common laws throughout the country. The ALI further attempts to clarify the common law and occasionally suggests changes to the common law. While the restatements are never formally attempted by state legislatures, they are extremely influential in courts and are cited frequently.

[9] *Restatement (Third) of Property: Servitudes* § 3.1(1) (2000).

[10] *Restatement (Third) of Property: Servitudes* § 3.1(3) (2000).

[11] *Restatement (Third) of Property: Servitudes* § 3.1(5) (2000).

[12] *Restatement (Third) of Property: Servitudes* § 3.2 cmt. a (2000)

property to pay a PTF covenant. It has been debated whether the Texas law only bans a buyer from paying the PTF covenant and or whether all residential PTF covenants are illegal. Some take the position that the seller, rather than the buyer, can be made to pay a PTF covenant under the Texas law. It is expected that further clarification of the law will occur during the 2011 Texas legislative session.

The four other states to act on PTF covenants have all banned their creation after the effective dates of the laws, leaving the enforceability of covenants created prior to enactment up to the courts. See Fla. Stat. Ann § 689.28 (Florida); Mo. Rev. Stat. § 442.558 (Missouri); Kan H.B. 2092 (Kansas); and 2009 Oregon Laws Ch. 298 (Oregon). The American Land Title Association and National Association of Realtors are currently working on a draft model legislation restricting the use of PTF covenants as well.

Recommendations

Policymakers should evaluate and assess the unintended consequences of PTF covenants. As these covenants become a focus of state legislatures, it will be essential for consumers, real estate practitioners, legislators and other stakeholders to familiarize themselves with PTF covenants and their role in a functioning land transfer system. Title professionals should take the following steps to ensure they are ready to understand PTF covenants:

- Familiarize yourself with PTF covenants, how they work, and the jargon associated with them. PTF covenants are beginning to be the focus of many state legislatures and have cropped up in discussion in academia, the news media and industry blogs.
- Determine what the law is in your jurisdiction regarding PTF covenants. PTF covenants may be regulated at both the state and local level. Some states have enacted strict bans while others are allowing use of PTF covenants within a certain regulatory framework.
- Familiarize yourself with the requirements of PTF covenant creation and how to locate PTF covenants. Educate yourself so you may educate consumers about their potential obligation and legislators about the unintended consequences of PTF covenants.
- Monitor state and local legislative activity for changes in the PTF covenant laws. Tell ALTA about activity occurring in your state.
- Communicate with your underwriter on how you should deal with PTF covenants now and in the future.