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November 12th, 2010

[DRAFT RESPONSE]

Center for Regulatory Effectiveness
1601 Connecticut Avenue, N.W., Suite 500
Washington, D.C. 20009

Re: Comments by the Center for Regulatory Effectiveness on FHFA's Proposed Guidance for Transfer Fees

Freehold Capital Partners ('Freehold') thanks the Center for Regulatory Effectiveness ("CRE" or the "Center") for the opportunity to respond to CRE's draft Comments regarding FHFA's Proposed Guidance for Transfer Fees. The Center has done an admirable job of assembling the issues and present a fair and balanced approach. We are pleased to provide our initial comments follows.

1. WE SUGGEST THAT PRIVATE TRANSFER FEES AS DEFINED IN THE CENTER'S LETTER DO NOT REPRESENT A "PURELY PRIVATE FOR-PROFIT INCOME STREAM FOR DEVELOPERS AND INVESTORS."

In today's environment, the phrase "for profit" has a negative connotation, yet profits drive growth, which in turn creates jobs and tax revenue. Nonetheless, in the context of a *capital recovery fee*, the term "for profit" is inaccurate. When a developer assesses a fee to recover significant capital improvement expenditures, the assessment is not a "private for-profit income stream" under even the most liberal interpretation.

Similarly, the inference that investors are somehow sitting back enjoying a passive income stream, while providing no benefit, ignores the time value of money, and is analogous to arguing that investors who buy road bonds, municipal bonds, and even Treasuries are providing "no benefit", but instead are enjoying some type of private income stream solely for profit.

Likewise, efforts to put Freehold into that bucket are similarly misplaced. Developers create capital recovery fees. They partner with Freehold because we bring value. If a developer does not see a value proposition they do not partner with us. One might as well rail against a municipality paying the underwriter, or a home buyer paying the appraiser. The developer owns the transfer fee and decides

whether or not we bring value. Similarly, the homeowner, in making a purchase decision, decides whether or not the home provides value at the price point at which the home is offered.

2. THE MATH USED IN THE CRE DRAFT LETTER IS IN ERROR. A HOMEOWNER IS BETTER OFF BUYING A HOME WITH A TRANSFER FEE.

We had a Ph.D. economist review your Figure 1, and the accompanying chart (Center draft letter at pg. 6). He observed the following:

Turnover Rate: Although the Center readily concedes (and the undisputed Census data shows) that homes sell on average every 11 years, the Chart inexplicably uses a five year turnover ratio. Homes do not sell every five years, so a Chart using a five-year turnover ratio is as relevant as a chart that uses 6 days or 60 years - which is to say that it is not relevant at all. If the objective is to understand and analyze the impact on the typical consumer, then one must use data for the typical consumer.

However, even if the arbitrary five-year turnover rate is used, *the transfer fee home is more beneficial once you fully develop out the math, as follows:*

Transaction Savings: If you pay less for the home, your closing costs are less, your mortgage interest is less, your monthly principal payments are less, your property taxes are less, your insurance is less, and (when you sell) your real estate commission is less. None of these saving are reflected in the chart, yet they undeniably exist.

Opportunity Costs: What does the consumer do with the Transactional Savings? It is reasonable to suggest that the consumer can (or, at least has the option) to pay down consumer debt. According to a recent article in the NY Times, the average interest carry on consumer debt is 14.28%. While the consumer is better off even with an opportunity cost (e.g. return on invested capital) as low as 4%, the reality is that the "average" consumer labors under a 14.28% interest carry. While we concede that a consumer might well choose to spend the money instead of reducing debt, the purpose of any analysis is to consider the typical consumer -not the "exception" that can always be found").

Lost Appreciation: As the economist pointed out, "the Center's concept of Lost Appreciation is logically flawed, not only because both homes appreciate at the same rate, but because it fails to take into account the Transactional Savings. As logic would suggest, and math will prove, if you can avoid a 6%

mortgage interest payment, and give up 2% appreciation, and invest the Transactional Savings, you are significantly better off than paying more for your home.[1]

The Correct Math.

We have included our own Chart 1 and Chart 2. The former uses the Center's five-year turnover assumptions, despite the fact that, as discussed above, there is no basis for using this unrealistic assumption. The latter (Chart 2) show the data with the actual turnover rate, and the actual Transaction Savings, clearly illustrating that the average consumer is better off by deferring part of the infrastructure costs, and by having those costs spread out over multiple infrastructure users over time.

The analysis is, to some extent, an exercise in theory.

The Center uses a 5% discount on the price of the home. In reality, the homeowner (e.g. the market) will decide the amount of the discount. We discuss this extensively, including citations to studies, in our FHFA comment letter. As the California Senate staff analysis correctly concluded, "the market will adjust to the fee".

3. THE PRESUMPTION THAT THERE EVEN NEEDS TO BE A CONSUMER SAVINGS IS FLAWED.

Capital recovery fees are assessed as payment for infrastructure and other tangible and intangible improvements. Wastewater lines, sewer lines, etc., as will the intrinsic value that is derived from the planning and design of the subdivision itself, will last for generations to come.

The fee is being assessed as a way to pay for these benefits. Are we to argue that consumers should be denied the option of choosing between buying, financing or leasing a car – even though there are significant cost differences associated with each choice – simply because we decide that we should choose for the consumer? Of course not.

Similarly, we should let developers decide how much they want to charge for their product, and let consumers decide how much they are willing to pay for the product. Critics suggest that this is true for the first sale, but argue that developers should not benefit from future sales. Not only does this have no basis in anything other than subjective view on how to pay for real estate development, but it ignores the reality that the benefits created by the developer are still inuring to the benefit of the future consumers.

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[1] To use the Center's logic, the more expensive we can make housing, the better off the consumer will be." However, this ignores the tangible "Transaction Savings", which more than offsets the "Lost Appreciation" shown on the Center's chart.

Further, the argument against giving consumers a choice about capital recovery fees ignores the fact that there are undoubtedly many consumers who would prefer a transfer fee community for the following (or other) reasons:

- Lower initial sales price, which leads to transaction savings.
- Ability to qualify for a smaller loan (e.g. can buy more home than otherwise would be possible).
- Intent to hold for a long period of time, thus perceiving a greater gain from the deferred payment for infrastructure.
- Appreciates, and wants to support, the charitable fee that is paid out of every capital recovery fee.[2]
- Appreciates and enjoys the developer's long-term interests being tied to the long-term value of the community.

Consumers may in fact be willing to pay a premium to live in the community and, more importantly, whatever the consumers decides to pay, it is the consumers voluntary choice. *The only consumer that will ever pay a transfer fee is one who voluntarily agrees to do so*.

4. WE DISAGREE WITH THE PRESUMPTION THAT THE DEVELOPER HAS NO RIGHT TO CREATE THE LONG-TERM INCOME STREAM.

In addition to number 3 above, the current debate ignores the reality that Developers offer a product, which the consumer can decide to purchase, or not. In developing a master planned community the developer creates something of lasting value. The layout of the development, the location of parks, the choice of amenities – all originate from the developer, and it is undeniably a creative work.

Each homeowner then voluntarily decides whether or not to buy in to that development and, similarly, subsequent homeowners make the same <u>voluntary</u> choice - and the value they derive, whether from property appreciation or personal enjoyment, flow <u>in part</u> from the developer's creative work. As such, there is no rational basis for arguing that the developer has no right to a residual interest in the community he created.

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[2] 5% of every capital recovery fee goes to a non-profit operating within the community to support clean air, clean water, open space, affordable housing, etc. This tremendous future endowment will build strong communities, which enhances property values. It also provides an intangible satisfaction to consumers who opt for this infrastructure funding mechanism.

In fact, the market should appreciate the benefits that come from having a developer who has a vested interest in creating long-term sustainable value. Simply put, a developer who creates longer lasting value for consumers benefits from higher transfer fee income, and a developer who pays little attention to long-term value will benefit less.

5. THE VANDERBILT LAW PROFESSOR IS CLEARLY NOT AN ECONOMIST.

With all due respect to Vanderbilt Law Professor Kelly Lise Murray, her conclusion that someone who improves their property must give up a percentage of the appreciation to "people who didn't contribute at all" is unfounded.

A consumer improving their home derives value from the improvement. Part of the value comes from the community in which they live. Adding a 200 square foot addition to a home in one community may be worth significantly more, or less, than the exact same addition in a different neighborhood. Therefore, it is undisputed that part of the value is derived from the community created by the developer – certainly one cannot argue that not even 1% of the value is derived from the community.

Once again, the presumption made by Ms. Murray is predicted upon the flawed assumption that a developer imparts no lasting value to the subdivision he conceives and creates. It also ignores the reality that the consumer will take into account the existence of the fee, and the possibility that the consumer may desire to make improvements, when negotiating a purchase price.

6. WE SUGGEST THAT THE CENTER IS IN ERROR WHEN IT CONCLUDES THAT "THE PRIVATE TRANSFER FEE COVENANT DOES NOT BENEFIT THE HOMEOWNER OR THE PROPERTY ASIDE FROM REDUCING THE COST OF THE PROPERTY."

The homeowner is better off having spent less for the property, and the property is now more marketable as 100% of the infrastructure costs is not built in to the sales price. This savings passes to each subsequent purchaser. As discussed in para. 3 above, there are numerous other benefits that can accrue to the consumer.

7. THE CENTER'S CONCLUSION THAT "RECORDATION OF THE COVENANT DOES NOT PROVIDE SUFFICIENT NOTICE"[3], AND THE STATEMENT THAT "THE PRESENCE OF A PRIVATE TRANSFER FEE IS NOT CLEAR",[4] IS CONTRADICTED BY THE EVIDENCE AND BY EXISTING STUDIES, INCLUDING THE RESTATEMENT THIRD.

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[3] Center's draft letter at p. 9

[4] Ibid at page 10.

Since the covenant is filed of record, the title company discloses the covenant. If you conclude that this is insufficient, then you must conclude that all restrictive covenants used by HOAs are equally concealed, *because the mechanism is exactly the same*. In fact, a capital recovery fee is more visible for the simple reason, as the Center points out, that the fee is contained in a stand-alone document, as opposed to being embedded in a lengthy restrictive covenant that addresses issues such as architectural review committees, sign regulations, permissible paint colors, voting rights and other matters.

In addition, and despite the fact that we strongly support additional disclosure documents, the entire debate surrounding "hidden fees" is a transparent effort by the title industry to avoid having to do that for which they are paid a generous fee: review the public records and disclose all encumbrances. In today's modern age, missed encumbrances are rare, which is why the title industry pays out less than 5% of premium dollars in claims – an unheard of profit margin in the insurance industry.

This evolution of decreasing concerns about notice is reflected in the *Restatement (Third) of Property: Servitudes*, which abandons "horizontal privity", "touch and concern," and limitations on benefits held in gross. *In the Restatement,* Professor Susan French,[5] ***who is an acknowledged expert on servitude law, community associations, and future interests,*** explained that alternative mechanisms for providing notice justified eliminating unnecessary rules:[6]

> "Servitudes law may be simplified substantially because particular rules designed to give notice are no longer needed. The modern technology of record systems and title search procedures, together with the protection recording acts afford, have made these rules superfluous."

In addition, over ten million homes have a transfer fee in place, **yet where is the evidence of these "missed fees" and consumer harm?** If transfer fees were a new phenomenon one could better understand the concerns over disclosure. However, there are millions of homes with these fees in place, yet virtually

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[5] UCLA Law Professor, where she teaches *Property, Wills and Trusts, and Common Interest Communities*. Her areas of expertise include the law of wills, trusts, future interests, servitudes (easements and covenants) and common interest communities. Harvard Law visiting professor. She is co-author of *Cases and Texts on Property* (with Casner, et al., 5th ed. 2004) and *Community Association Law* (with Hyatt, 2d ed. 2008).

[6] Houweling (Asst. Prof of Law – UC Berkley, Boalt School of Law). *The New Servitudes*, The Georgetown Law Journal. Vol. 96:885, note 51, citing Susan F. French, *Design Proposal for the New Restatement of Property—Servitudes*, 21 U.C. DAVIS L. REV. 1213, 1225 (1998); Epstein, *supra* note 1, at 1358 (arguing that "**with notice secured by recordation, freedom of contract should control**"); Hansmann & Kraakman, *supra* note 34, at S407 (explaining that "registries developed for verifying ownership of land" avoid "many of the additional system and nonuser costs that effective verification of these rights would otherwise require"); Merrill & Smith, *Optimal Standardization*, *supra* note 6, at 40 (noting that "recording acts . . . . lower[] the costs of notice [and are] an alternative method of lowering information costs"). On recording acts generally, see POWELL, *supra* note 49, §82.01. On marketable title acts, see *id*. §82.04.

no evidence of missed fees. More importantly, 100% of the "missed fees" would by definition be the fault of the title industry.

8. WE BELIEVE THAT CRITICISM OF THE "FIRST SALE" EXEMPTION IS MISPLACED.[7]

It would make no sense for the developer to pay himself a fee. In addition, if the developer were to pay himself a fee, this would do nothing to improve or diminish the disclosure made by the title company, because the title company disclosure comes during the title review period (at which time the buyer can back out) whereas the payment of the first fee, even if it occurred, would not appear until the closing statement. The criticism is, therefore, clearly misplaced.

9. THE NY TIMES QUOTE THAT THE "FEE IS OFTEN HIDDEN IN DOZENS OF DOCUMENTS"[8] IS A QUOTE BY A LOBBYIST FOR THE TITLE INDUSTRY, AND IS FACTUALLY INACCURATE.

A quote by a title industry lobbyist is not a fact. As discussed above, and as recognized by the Center, the fee is disclosed in a stand-alone document, boldly titled. As noted by Professor French, there is no reason the title industry should miss the fee. And, as millions of transaction have shown, the fee in fact is neither hidden nor missed.

According to real estate attorney Robert Wilson, commenting on the article, "since the typical closing involves less than 20 documents, of which 4 to 5 are disclosure documents, it seems hard to imagine how such a hypothetical and gross exaggeration as the one contained in the story is actually relevant to the discussion of private transfer fee disclosure." (See also http://www.buying-new-home.com/course61.php)

10. THE CENTER ARGUES THAT CONSUMERS LACK PERFECT INFORMATION,[9] YET PROFESSOR FRENCH (AND THE RESTATEMENT) CONCLUDE OTHERWISE.

As discussed (para. 6), the Restatement multi-year study, authored by an acknowledged expert in the field, concluded that consumers do have near perfect information.

Studies cited in our FHFA letter also indicate that the market does take into account the existence of a fee, and discounts accordingly. The Center should concede that there is no evidence to support the subjective conclusion that consumers do not have adequate information.

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[7] CRE Letter, page 9
[8] Ibid.
[9] CRE Letter, page 11

Notwithstanding the foregoing, to the extent a concern exists, the concern can be conclusively resolved by disclosure, such as H.R. 6332.

11. WE DISAGREE THAT A "PRIVATE TRANSFER FEE IS A COMPLEX MECHANISM FOR CONSUMERS TO UNDERSTAND".

Not only do the studies show that consumer do take the fee into account when making a purchase decisions, but if a consumer cannot understand "*1% paid when they sell*", then they certainly cannot understand the mortgage, the title policy, or the subdivision restrictions, which are infinitely more complex. Conversely, if the buyer CAN understand the mortgage documents, the title policy, the subdivision restrictions, etc., then clearly they can understand "*1% paid when you sell*".

The reality is that there is nothing to distinguish a private transfer fee from other closing documents, including HOA documents, mortgages, etc. It is one of the easiest documents to understand, and a disclosure regime can only enhance that process by creating a redundancy to existing disclosure that occurs through the title review process.

12. THE FHLBNY ATTEMPTS TO DISTINGUISH BETWEEN "GOOD" FEES AND "BAD" FEES, WHICH HAS NOTHING TO DO WITH THE IMPACT ON MORTGAGES.

The FHLBNY makes a moral judgment, predicated upon the flawed assumption that a capital recovery fee is a private income stream that provides no benefit to the consumer. Setting aside the argument as to whether or not that is true (since the consumer undeniably pays less up front), the FHLBNY then seeks to rationalize keeping condo fees and similar assessments based on the unfounded assumption that

13. WE AGREE WITH THE THE CENTER'S CONCLUSIONS AS FOLLOWS:

- The efficacy of for-profit transfer fees is determined in large part by the effectiveness of national disclosure program. (p.11)
- In a tight credit market, for-profit private transfer fees may provide consumers with the opportunity to purchase a home at low cost, which will increase demand and homeownership. (p.13)
- Moreover, many of the risks associated for-profit private transfer fees also apply for (sic) community transfer fees. (p.14)
- However, disclosure requirements that provide consumers with actual notice and knowledge of the private transfer can cure the lack of clarity surrounding private transfer fees. (p.15)

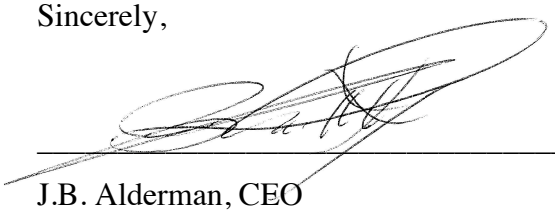
14. WE BELIEVE THAT FIGURE 4 ON PAGE 16 SHOULD BE OMITTED.

Capital recovery fees lower homeownership costs. This provides at least as much benefit as co-op associations, affordable housing development, etc. All of the fees are disclosed through the same manner, and are paid by a willing party. To suggest heightened regulatory scrutiny based on the misplaced concept that private transfer fees are somehow morally inferior to other fees ignores the basis for, and the benefit provided by, the fee.

Summary

We appreciate the opportunity to comment on the draft CRE letter, and look forward to speaking with you further regarding this matter.

Sincerely,



J.B. Alderman, CEO