

A Primer on Transfer Fees

By Keenan Kolendo and Holly H. Lewis

Transfer Fee Instruments have become a hot topic of conversation and debate in the real estate community. “Transfer Fee Instruments” are declarations or covenants recorded against the title to real property that require the payment of a transfer fee (also known as a reconveyance or conveyance fee) to the declarant or a third party upon a subsequent transfer of the real property. The fee is typically a percentage (e.g., 1%) of the sales price, and non-payment can result in the establishment of a lien against the property (in the amount of the unpaid fee, plus interest).

The use of Transfer Fee Instruments in non-profit contexts that result in some benefit to the subject property is generally accepted. Transfer Fee Instruments have been used to finance a variety of non-profit initiatives, such as community centers, parks, environmental programs, affordable housing, and homeowners’ associations that continue to actively contribute to the burdened property. It is worth noting that annual homeowners’ association dues are not transfer fees because those dues accrue regardless of whether or not the property has been transferred. In some cases, special homeowner’s association assessments may accrue due to a conveyance of subject property. This type of assessment is a transfer fee.

The debate over Transfer Fee Instruments typically begins when a portion of the transfer fee goes to a private developer or a third party who, in the opponents’ opinion, provides no ongoing benefit to the property. This use of transfer fees as a for-profit venture has come under fire from critics, and several states have moved to ban them. Proponents argue that this “for-profit” structure allows the developer to finance a development, allowing the initial purchaser of the real property to purchase the developed property at a discounted price. Of course, there are other policy arguments on both sides of this debate, which are beyond the scope of this article.

Application of Common Law to Transfer Fee Instruments

Opponents of for-profit Transfer Fee Instruments argue that such instruments violate common law. A Transfer Fee Instrument is a servitude, and absent the enactment of statutory regulations governing enforceability, a servitude is governed under either common law or the Restatement (Third) of Property: Servitudes. Depending on which approach a jurisdiction adopts, the outcome with respect to the enforceability of a Transfer Fee Instrument can vary.

Under common law, in order for a servitude to run with the land, there is a requirement that the servitude “touch and concern” the land. Courts have long struggled with the application of the touch and concern requirement for affirmative covenants to pay money and have generally held that covenants that create purely personal benefits do not satisfy this requirement. In order to satisfy the touch and concern requirement, there must be a reasonable nexus between the benefit, the burden, and the effect of the servitude upon the enjoyment of the land. For example, a covenant that requires an annual payment to a homeowners’ association, with the funds being used to improve the overall condition of the neighborhood, would likely meet the touch and concern requirement since the fee is used for improvements that ultimately benefit the homeowner.

However, in the context of Transfer Fee Instruments, many times the nexus between the benefit and the burden is lacking. Specifically, the affirmative covenant to pay money to a developer, rather than a homeowners' association, is a covenant that results in a personal benefit to the developer that continues even after the developer no longer has any legal interest in property within the development. As a result, it is likely that a court would view that covenant as personal to the developer and thus, as a covenant that fails to meet the "touch and concern" requirement.

In 1998, following years of criticism as to the vague, confusing, and complex nature of the touch and concern requirement that provided the courts with a wide range of judicial discretion in policing servitudes, the American Law Institute ("ALI") abandoned the touch and concern requirement in the Restatement (Third) of Property: Servitudes. In its stead, ALI relies on a general presumption that a servitude will run with the land if the original parties so intended, provided the servitude is not illegal, unconstitutional, or against public policy. According to ALI, a servitude violates public policy if the servitude is "arbitrary, spiteful, or capricious", if it "unreasonably burdens a fundamental constitutional right", if it "imposes an unreasonable restraint on alienation", if it "imposes an unreasonable restraint on trade or competition", or if it is "unconscionable". ALI's position is based on freedom of contract as a fundamental principle of the American legal system. Because of this right, parties should be free to contract as they wish and courts should enforce those agreements without passing judgment on their substance. Proponents of for-profit Transfer Fee Instruments put forward the position taken by ALI to support the enforceability of these instruments. If a jurisdiction follows the Restatement (Third) of Property, proponents may succeed in enforcing those instruments. However, opponents of Transfer Fee Instruments will still make a public policy argument supported by the Restatement that those instruments impose an unreasonable restraint on alienability as neither the parties, nor the land subject to the transaction, derive any benefit from such a fee.

State Law Responses to Transfer Fee Instruments

Considering that the use of Transfer Fee Instruments is a relatively new practice, most states have not passed laws that specifically govern their enforceability. However, within the last few years, Florida, Missouri, Utah, Kansas, and Oregon have enacted statutes that effectively ban Transfer Fee Instruments for all real property in the state, subject to exceptions for certain types of non-profit transfer fees.

Texas has enacted a statute that prohibits the use of Transfer Fee Instruments for residential property only, with some exceptions for non-profit Transfer Fee Instruments. It is worth noting that opponents and proponents of for-profit Transfer Fee Instruments debate whether Texas' statute is a blanket prohibition. Those in favor of private transfer fees contend that the language only prohibits a buyer from paying the fee, while transfer fee opponents argue that the statute prohibits all for-profit transfer fees applicable to residential real property.

California has also taken action on this issue. Rather than prohibiting Transfer Fee Instruments, recently enacted California statutes require either that notice of any Transfer Fee Instrument be recorded against title to the burdened property or that notice be given to the potential transferee of the burdened property.

In addition, there have been efforts in Ohio, Arizona, Louisiana and Hawaii to enact legislation that restricts for-profit Transfer Fee Instruments.

In summary, a transfer fee is essentially a private real estate-based assessment that accrues upon the transfer of property that is subject to a Transfer Fee Instrument. Some states have enacted laws that specifically prohibit (or in one case, allow) for-profit transfer fees. However, in most cases state law does not specifically address the enforceability of transfer fees. In these states a transfer fee that benefits the property burdened by the Transfer Fee Instrument is likely to survive judicial scrutiny, while the fate of a transfer fee that does not benefit the burdened property will likely depend upon whether the common law or the The Restatement (Third) of Property is followed.

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