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A new real estate cost to watch for: Developer's private transfer fee

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Kenneth R. Harney
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How about this for a new and ingenious real estate money machine? Every time a house sells during the next 99 years, 1 percent of the price goes back to the original developer or is shared among investor partners. Ka-ching!

The levy won't be subject to haggling between future buyers and sellers, either. That's because it's a covenanted mandate -- a novel type of lien on the underlying real estate -- called a private transfer fee. It's not a government transfer tax. Nor is it a homeowner association or environmental protection covenant. It's purely a private requirement that runs with the land. If a seller refuses to pay it to a third-party trustee at closing, the sale won't proceed.

Sounds like a great deal -- provided that you're on the collecting end of a near-perpetual revenue stream. Apparently, the idea has been attractive enough that substantial numbers of developers and builders are signing up with a New York-based company that has devised what it calls a "patent pending" system to tap into real estate transactions into the next century.

Manhattan-based Freehold Capital Partners declines to identify any clients or participants in its private-transfer-fee program, but it claims on its Web site that as of late 2009, "the owners of an estimated \$488 billion in real estate projects nationwide, including some of the country's largest, most well-respected companies, have partnered with Freehold."

The company says it is negotiating with institutional investors to "securitize" pools of transfer fees -- essentially creating bonds based on future cash flows that can be sold to deep-pocket money managers.

Freehold's activities have stoked legislative controversies in several states, and real estate trade groups that oppose the private-fee concept plan to fight it across the country in the coming months.

The National Association of Realtors and the American Land Title Association, for example, are asking their members to persuade legislators to prohibit or limit the use of investor-oriented private-transfer-fee programs. Even the National Association of Home Builders, some of whose members reportedly have signed up to participate in the transfer fee program, isn't convinced that the idea is sound.

"It's a very creative concept," said David Ledford, the builder association's senior vice president for housing finance, "but it's largely untested and controversial politically."

For its part, Freehold maintains that its transfer-fee covenants are good for consumers and good for cash-strapped builders. Curtis Campbell, a spokesman for the firm, said in an e-mail that "private transfer fees represent an adaptation in how to pay for development costs" incurred by builders "at a time when funding is not available" to them on "reasonable terms."

Freehold's system allows developers and builders to recoup some of their infrastructure costs -- project amenities, environmental protection and land-use requirements imposed by local governments -- without lumping them onto the price paid by the first buyer of a house.

By creating future revenue streams -- which builders can monetize upfront by selling to investors -- the plan allows developers to sell houses for lower prices than they otherwise could, Campbell said.

Critics charge that the program will taint houses encumbered with transfer fees for decades, lowering their values and making them harder to sell. Real estate attorney Robert A. Franco, of Mansfield, Ohio, said the concept is also "certain to lead to litigation" years from now, "since many buyers may not be aware" of the fees. Future buyers may also challenge their legal validity in court, balk at settlements and jeopardize property sales, Franco said.

According to a white paper prepared by the American Land Title Association, six states have limited or restricted private transfer fees: California, which requires upfront disclosures; Texas, which prohibits the fees in certain circumstances; and Kansas, Oregon, Florida and Missouri, which ban them.

A Utah developer who signed up with the program but has since withdrawn said the underlying purpose is worthwhile. Nate Shipp, managing partner of Development Associates Inc., said in an interview that many builders and developers would like to be able to receive compensation for some of the heavy upfront costs they bear in creating a new community.

But DAI "pulled off" the covenants attached to recent home sales, he said, in part because they bothered some purchasers and because DAI "never received anything" in exchange. One of DAI's home buyers, Camber Keiser of Eagle Mountain, Utah, said the fee "was not disclosed" at the time of purchase, "so yes, we were surprised to learn of it" and pleased that DAI removed it.

Most states still have no restrictions on the fees, and most home buyers are likely to be unaware of them. So look for them before signing any contract.