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Christopher D. McEachran

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Sometimes Jumping on the Bandwagon is a Good Thing: An Analysis of North Carolina’s Prohibition of Transfer Fee Covenants*

INTRODUCTION

For the past ten years, homeowners across the country have been discovering that when it comes to contracts to purchase real property, it pays to read the fine print.¹ In the early 2000s, a Texas company began attaching private transfer fee covenants² (“TFCs”) to properties in residential communities.³ A TFC purportedly allows the developer to collect one percent of the sales price from future sellers every time the property is sold for the next ninety-nine years.⁴ There are many problems with this practice, but the principal concern is that a private third party, who has no legal interest in the property other than the TFC, will receive the benefit of the covenant—one percent of all future sales—while future buyers receive no benefit and bear the burden of paying the one percent transfer fee.⁵

Numerous groups oppose the use of TFCs, including the National Association of Realtors (“NAR”) and the American Land

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³ See Carpi, supra note 2.
⁴ Bardwell & Durham, supra note 2, at 25; Morrissey, supra note 1, at BU1.
⁵ See R. Wilson Freyermuth, Putting the Brakes on Private Transfer Fee Covenants, PROB. & PROP., July–Aug. 2010, at 20, 22.
Title Association ("ALTA"). These groups have been lobbying state legislatures across the country in an effort to prohibit the use of TFCs, currently resulting in bans or restrictions in thirty-six states. On July 1, 2010, North Carolina added its name to the list of states that prohibit TFCs in most circumstances.

This Recent Development argues that by joining the national movement against TFCs, North Carolina is implementing sound public policy that clarifies and strengthens traditional property rights. Part I discusses the principles of the TFC system, including the alleged benefits and likely burdens created by its implementation. Part II analyzes the recent North Carolina statute prohibiting TFCs and discusses the changing property law principles that form the basis of the new statute. More specifically, Part II highlights the distinction between TFCs paid to private parties and those paid to community associations as an illustration of the common law property principle that covenants purporting to run with the land must be rational and not against public policy. The new North Carolina statute strengthens common law property principles already present in the

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7. See Map: State Laws Against Wall Street Resale Fees, COALITION TO STOP WALL STREET HOME RESALE FEES, http://stophomeresalefees.org/state-laws-against-wall-street-home-resale-fees (last visited Aug. 22, 2011) (hereinafter Map, COALITION). Recently, as a result of the Coalition's efforts, the Federal Housing Finance Agency ("FHFA") issued a proposed guidance that would prohibit federal loan agencies from dealing in mortgages encumbered by TFCs. Private Transfer Fee Covenants, 75 Fed. Reg. 49,932 (Aug. 16, 2010). Moreover, Congress also proposed a bill that would codify the FHFA's guidance a little more than a month after it was issued. Homeowner Equity Protection Act of 2010, H.R. 6260, 111th Cong. (2010). Because the Congressional session ended without this bill being passed, it is not useful for analysis in this Recent Development other than to point out the swiftness and effectiveness of the Coalition's opposition to the use of TFCs.

8. See Transfer Fee Covenants Prohibited Act of 2010, 2010 N.C. Sess. Laws 245 (codified at N.C. GEN. STAT. § 39A (Supp. 2010)). However, under the definitions section of the Act, transfer fees are allowed to be paid to a homeowners' association. N.C. GEN. STAT. § 39A-2(i) (Supp. 2010).

9. RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.2 (2000). This concept replaces the "touch and concern" standard that has been articulated in the past. Id. § 3.2 cmt. a. This Recent Development argues that the courts have been interpreting the "touch and concern" standard to mean "rational and not against public policy," as reflected in the recent history of case law. See infra Part III.A.
state. It prevents the spread of a practice that would be against the public policy of the state,\(^{10}\) while allowing homeowners’ associations to utilize the TFCs format to fund their operating costs.\(^{11}\) The second half of this Recent Development discusses the principal legal concerns facing the TFC model and how the North Carolina statute addresses these concerns. Part III argues that TFCs do not meet the traditional “touch and concern” standard that guides enforceability at law.\(^{12}\) Part IV contends that even absent the new statute, TFCs are against public policy—and therefore unenforceable at law—because they restrain the free transferability of property.\(^{13}\) By codifying these principles as a response to the specific threat of the TFC model, the North Carolina General Assembly prevented future abuse while maintaining common law principles of property transfer.

I. THE PRINCIPLES AND PRACTICE OF THE TRANSFER FEE COVENANT

For decades, transfer fees have been used by developers and homeowners alike to fund a variety of mutually beneficial entities, including homeowners’ associations\(^{14}\) and nonprofits such as environmental protection covenants\(^{15}\) or conservation easements.\(^{16}\)

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10. See infra Part II.B.


12. See infra Part III.

13. See infra Part IV.


15. See Kenneth R. Harney, New Fee Could Be Boon to Developers, Surprise to Buyers, WASH. POST, Mar. 6, 2010, at E1 (implying that homeowners’ associations or environmental protection covenants are the typical and accepted uses of transfer fees).

16. See Update on Charitable Transfer Fees and Call to Action, LAND TR. ALLIANCE (Apr. 7, 2011), http://www.landtrustalliance.org/conservation/conservation-defense-news/update-on-charitable-transfer-fees-and-call-to (calling for supporters to petition Congress to allow for land conservation easements to continue to receive funds via transfer fees). Transfer fees that are payable to nonprofit organizations, such as homeowners’ associations and environmental covenants, typically would be valid as they provide an ostensible benefit to the community. Freyermuth, supra note 5, at 25. For example, builders in California have used transfer fees for twenty years as part of an agreement to satisfy the demands of various environmental groups, funding the groups’ efforts in preserving open space in exchange for a lawsuit-free residential development project. Kelly Quigley, Front Lines: Private Transfer Taxes, A New Buyer’s Burden, REALTORMAG (Sept. 1, 2007), http://www.realtor.org/rmoprint.nsf/pages
TFCs paid to private third-party beneficiaries, however, are a more recent development. The private TFC is a new type of servitude, different in purpose and effect from covenants that require transfer fees to be paid to homeowners' associations each time the property is resold. During the ninety-nine year term of a TFC, the seller in all future sales is required to pay a one percent fee to a trustee named in the TFC. In return for his efforts tracking the property title, the trustee is paid a small fee. The remaining proceeds are distributed to the named beneficiaries. This list nearly always includes the developer, the trustee, and the "licensing" company that developed the TFC business model. Sometimes, real estate agents or brokers as well as local nonprofit organizations identified in the TFC document share the future revenues. If a future seller or buyer does not pay the transfer fee, the TFC gives the trustee a lien on the property, which may be foreclosed in order to secure the unpaid transfer fee.

/frontlinesledesep07. Freehold Capital Partners, the leading advocate for the TFC model, has attempted to include these traditional beneficiaries in an effort to maintain "touch and concern" with the burdened land. See infra notes 50–53 and accompanying text.

17. See, e.g., Carpi, supra note 2 (informing the real estate community of the "innovative new programs" known as TFCs as late as 2007).

18. A criticism of the TFC model is that it is "an attempt by the covenantor to retain part of the fee simple title without having any right of possession presently or in the future," thus creating a new estate in land "beyond those recognized at common law." Bardwell & Durham, supra note 2, at 28. This critique further posits that such an attempt to create a new interest in land would likely be rejected by any court asked to enforce it. Id.

19. Traditional TFCs would benefit homeowners' associations or environmental covenants. See supra notes 14–15 and accompanying text. The private TFCs at issue in this Recent Development benefit private third parties—developers, brokers, and licensors—without benefiting the land. See infra Part III.B. For the remainder of this Recent Development, "TFC" will be used to signify the private transfer fee covenant payable to private third-party beneficiaries.

20. See, e.g., Bardwell & Durham, supra note 2, at 25; Freyermuth, supra note 5, at 21.

21. See Freyermuth, supra note 5, at 21.

22. See Bardwell & Durham, supra note 2, at 25; Freyermuth, supra note 5, at 21.


24. Freyermuth, supra note 5, at 21.

25. Id. For example:

[assume that ABC Land Co. is developing a 500-lot residential subdivision, known as Shady Acres, and wants to impose a [TFC] on each lot. As in any typical development, [ABC] records a declaration within the chain of title for each lot in Shady Acres. The declaration imposes a [TFC] that purports to run with each lot and bind subsequent owners for a 99-year period. This covenant does not impose a fee on the first sale, so when [ABC] sells a home to the initial homebuyer (whom
A developer beginning to implement the TFC model may choose to deal with the future income in one of two ways. First, a developer may decide to keep the right to the transfer fee, collecting a portion of the one percent fee upon every future resale. Second, the developer may wish to sell the transfer fee right to a third party, who may in turn decide to purchase many transfer fee rights, in order to create a pool of future interests to sell as securities on the open market. The principal advocate for the practice of pooling and securitization, and possibly the only party actively pooling transfer fee rights in hopes of securitizing them, is Freehold Capital Partners.

A. Freehold Capital Partners and the Benefits of Transfer Fee Covenants

Texas developer Joseph B. Alderman, III’s Freehold Capital Partners (“Freehold”) has become “the best known and most controversial” promoter of the TFC model. Freehold claims that the

we will call Jones), Jones pays no transfer fee. The covenant, however, provides that if Jones resells the home during the 99-year term of the covenant, Jones must pay a fee equal to 1% of the purchase price. If Jones does not pay the fee, the declaration provides that the trustee has a lien on the land to secure the unpaid transfer fees and can foreclose that lien (including by nonjudicial process, to the extent permitted by other state law) to satisfy the fee payment obligation.

Id.

26. Id.

27. Id. The “inventor” of the TFC, Freehold Capital Partners, outlines a business plan in which TFCs, or instruments, would be “aggregated into large 'pools' and securities backed by the pool would then be issued.” FREEHOLD CAPITAL PARTNERS, supra note 2; Whelan, supra note 6.

28. FREEHOLD CAPITAL PARTNERS, supra note 2 (“Freehold and its partners have created a tremendous portfolio of [TFC i]nstruments covering thousands of projects nationwide, thus making income predictions a realistic possibility, which in turn makes [securitization] feasible.”); see, e.g., Kenneth R. Harney, Diverse Coalition Targets Home Transfer Fees, WASH. POST, Aug. 7, 2010, at E1; (referring to Freehold Capital Partners as the “principal advocate” of the TFC practice).

29. See Kenneth R. Harney, Proposed Ban on Private Transfer Fees Could Have Hidden Costs, WASH. POST, Aug. 21, 2010, at E1; Morrissey, supra note 1, at BU1. Initially, the company was known as “Freehold Licensing” and the servitude was known as a “Transfer Fee Instrument[]” (now changed to “Reconveyance Fee Instrument[]”). Robert Franco, Freehold Licensing, NKA Freehold Capital Partners, At It Again, SOURCE OF TITLE (Feb. 27, 2010), https://www.sourceforgeoftitle.com/blog_node.aspx?uniq=568. One blogger suggests that Alderman changed the name of the company and the instrument to avoid the negative publicity it had garnered in the initial years of promoting the TFC program. Id. However, the change in names has not altered the core concepts behind the TFC program and has been accompanied by an expansion of the business plan, now including plans to securitize the TFC interests and sell them on the open markets. Id. For simplicity, the term Freehold will be used to describe the company regardless of the year referenced.
TFCs benefit consumers and "cash-strapped builders" alike.\textsuperscript{30} To understand the developers' perspective, it is helpful to provide some context. Builders and developers benefit from the use of TFCs in two principal ways—TFCs increase capital at the outset of a project, which helps offset increasing production costs, and TFCs guarantee a future income stream that rewards builders and developers for the expected increase in value of the homes they build.

In many parts of the country, before a large-scale residential project can break ground, developers must first defend lawsuits from private citizens' groups seeking to prevent the construction from harming the environment.\textsuperscript{31} In addition to legal fees and settlement sums, local governments also impose large impact fees on project developers before construction can begin.\textsuperscript{32} These high costs can inhibit developers from beginning new projects. Consequently, some developers have begun including TFCs in their development plans in an attempt to offset the costs of beginning these new projects.\textsuperscript{33}

Furthermore, for many years, some builders and developers have argued that they were "creating wealth for everyone but themselves," contending that, as the builders and initial sellers, they do not receive adequate compensation for the future increase in value of the homes they build.\textsuperscript{34} They further argue that this lack of compensation has become even more pronounced during hard economic times, as they often do not make a profit from the sale of a newly constructed home that will sell in the future for much more than the original purchase price.\textsuperscript{35} These developers see the TFC model as a "small honorarium for creating [the] value for all who come later."\textsuperscript{36}

Alderman and the people at Freehold recognize that developers are desperate for a way to increase profits and have responded by aggressively pitching the TFC program to builders and developers across the country.\textsuperscript{37} Developers have responded to these efforts, turning to the Freehold TFC model as an alternative to the traditional real estate transaction, in which 100% of these costs are placed onto

\begin{itemize}
\item \textsuperscript{30} Harney, supra note 15, at E1.
\item \textsuperscript{31} Quigley, supra note 16.
\item \textsuperscript{32} Id.
\item \textsuperscript{33} See Morrissey, supra note 1.
\item \textsuperscript{35} See id.
\item \textsuperscript{36} Id.
\item \textsuperscript{37} See Morrissey, supra note 1.
\end{itemize}
the initial buyer. Using Freehold’s TFC model, the developer can argue that he is distributing the development costs to all future owners over the lifetime of the property while offering a discount to the initial buyer. The TFC model presents developers with a “creative” method of financing new developments, as the steady “trickle of cash” from the future payment of the fees can be used as collateral for a loan to finance future developments, which then leads to more fees being paid. Alternatively, TFCs can allow developers to get cash up front if TFCs are pooled together and packaged into securities backed by the income stream generated by the transfer fees and sold on Wall Street. Using either method, TFCs provide a needed source of income for developers, allowing them to lower initial sale prices, pay down bank loans, and restart failed projects.

From the buyer’s perspective, accepting the one percent transfer fee allows the buyer to negotiate for a lower initial sale price, which reduces carrying costs and allows the buyer to reallocate the money to pay off other current debts. In its promotional material, Freehold offers the potential buyer two sample options: (1) buy the house for $250,000, or (2) buy the same house for $245,000 plus a one percent transfer fee when the house is sold. When faced with such a choice, the rational buyer would presumably choose the second option. In return for accepting the one percent transfer fee, the buyer can buy

38. See FREEHOLD CAPITAL PARTNERS, supra note 2.
40. Morrissey, supra note 1.
41. Id. ("Freehold has begun shopping the idea of securitizing the resale fees, much as subprime loans were packaged and sold to investors."); Whelan, supra note 6. Freehold claims to be “the owners of an estimated $488 billion in real estate projects nationwide,” which it plans to group together into large “pools of transfer fees” which can be securitized, essentially “creating bonds based on future cash flows that can be sold to deep-pocket money managers.” Harney, supra note 15.
42. See Harney, supra note 15; Fava, supra note 14. However, not all developers are on board with the Freehold TFC model. Many are concerned that the program may turn out to be illegal. Quigley, supra note 16. One executive of the National Association of Homebuilders, a group whose members have already signed up with Freehold, stated that while TFCs are a “very creative concept,” they are “largely untested and controversial politically.” Harney, supra note 15.
43. McPeak, supra note 39. Once the TFC is disclosed to the rational buyer, “economic theory suggests that buyers armed with the facts will not pay the same for a home with a transfer fee as they will pay for the same home without the transfer fee. It would be illogical to argue otherwise.” Id.
44. FREEHOLD CAPITAL PARTNERS, supra note 2.
45. See McPeak, supra note 39.
for less and sell for less, which is a “competitive advantage”; save on closing costs and sales expenses; and secure a lower mortgage rate. Supporters of the TFC model are careful to note that a buyer who does not agree to the TFC may simply go elsewhere, as there are numerous housing options for those who prefer to pay 100% of development costs at the outset. The TFC model presents an alternative to the traditional real estate transaction, which results in a lower initial and resale price, giving the buyer a “competitive advantage.”

In addition to the benefits to prospective buyers, local communities also benefit from the TFC program. The Freehold TFC model almost always requires that a portion of the income from a TFC, usually five percent, be allocated to a community-oriented nonprofit organization. These nonprofits are distinct from homeowners’ associations, which have traditionally utilized a similar transfer fee payment to fund their operating costs. The nonprofits identified in the Freehold TFCs are not directly associated with the residential community like a homeowners’ association, but instead provide long-term funding for “clean air, clean water, green space, literacy, affordable housing and similar endeavors that help build better communities and enhance the quality of life” locally where the Freehold TFCs are implemented. According to the company’s promotional material, “Freehold’s system combines economic incentives for property developers with a charitable component, which means that [TFC] income generated by Freehold is estimated to far outpace the income stream generated by other types of transfer fees imposed on a pure ‘non-profit’ basis.”

46. FREEHOLD CAPITAL PARTNERS, supra note 2 (characterizing the ability to buy and sell for less as a “competitive advantage”). However, there are those who would argue that a lower resale value is not desirable at all, and that the imposition of a TFC reduces the incentive for a buyer to invest in their home, as they know that they will not realize the full potential of their investment due to the future transfer fee payment. Snipes, supra note 23.

47. See McPeak, supra note 39.
48. See FREEHOLD CAPITAL PARTNERS, supra note 2.
49. Id.
50. McPeak, supra note 39.
51. See Freyermuth, supra note 5, at 21-22.
52. Freehold Capital Partners Announces $348,000,000.00 North Carolina Project, PR NEWSWIRE (May 25, 2010), http://www.prnewswire.com/news-releases/freehold-capital-partners-announces-34800000000-north-carolina-project-94807854.html; see FREEHOLD CAPITAL PARTNERS, supra note 2; McPeak, supra note 39.
53. FREEHOLD CAPITAL PARTNERS, supra note 2.
B. Transfer Fee Covenants Face Opposition on a National Scale

As intently as Freehold and its supporters advocate for the widespread use of the TFC model, the opposition, led by NAR and ALTA is advocating against the use of TFCs. Kurt Pfotenhauer, chief executive of ALTA, expressed the groups' principal concerns: TFCs are "bad public policy and bad for consumers." This is because the "private transfer fees hinder the safe and secure transfer of property[,] . . . provide no service or benefit to homeowners, and raise the cost of homeownership." ALTA believes that TFCs are "designed to generate additional revenue for investors at the expense of consumers."

In recent years, as the use of TFCs has increased, both NAR and ALTA have adopted similar policy statements against the use and enforcement of private TFCs that essentially echo the sentiments expressed by Mr. Pfotenhauer. Beginning in 2008, ALTA and NAR teamed together to lobby state legislatures to ban TFCs. This effort proved to be very successful, resulting in legislative changes that restrict or ban TFCs in thirty-six states. Following their success at the state level, NAR and ALTA took the battle to the federal level by joining forces with several consumers' rights organizations and labor unions to form the Coalition to Stop Wall Street Home Resale Fees ("the Coalition") in late July of 2010. The Coalition views TFCs as "predatory legal instruments that threaten American homeowners by forcing them to pay a premium for the right to sell their own property.

54. See Harney, supra note 28.
55. Id.
57. Id.
58. See Freyermuth, supra note 5, at 24 ("ALTA’s statement provides that ‘these covenants provide no benefit to consumers or the public, but rather cost consumers money, complicate the safe, efficient and legal transfer of real estate, and depress home prices.’ . . . The NAR’s statement argues that ‘such fees decrease affordability, serve no public purpose, and provide no benefit to property purchasers, or the community in which the property is located.’").
59. See Fava, supra note 14. In 2008, the California legislature decided to permit TFCs so long as they were properly disclosed. CAL. CIV. CODE §§ 1098, 1098.5 (West 2011). Following their defeat in California, NAR and ALTA began lobbying other states to ban TFCs. Fava, supra note 14.
61. See Margaret Jackson, Resale Fees Under Attack, DENVER POST, July 30, 2010, at 5B; About, Coalition, supra note 6.
and by burdening the land without benefiting the land." The Coalition's ultimate goal is to lobby the federal government to enact legislation that would outlaw "capital recovery fees," or TFCs.

II. NORTH CAROLINA JOINS THE NATIONAL MOVEMENT TO BAN TRANSFER FEE COVENANTS

In 2010, North Carolina and eleven other states passed laws that prohibit or severely restrict the use of TFCs, increasing the total number of states prohibiting or restricting TFCs at that time to eighteen. On July 1, 2010, the North Carolina General Assembly passed section 39A of the General Statutes of North Carolina entitled "Transfer Fee Covenants Prohibited." The new statute restates North Carolina's public policy regarding real property transfers and specifically prohibits private TFCs, while allowing homeowners' associations and environmental covenants to utilize the TFC model to collect funds. Even though the TFC model had not become standard practice in North Carolina, opponents of the fees, such as the Coalition, lobbied for the prohibitive law to prevent the TFC model from becoming "more commonplace." While opponents may

62. The Issue, COALITION, supra note 60.
63. See Whelan, supra note 6. Freehold Capital Partners prefers the term "Capital Recovery Fees," presumably because of the more positive business connotation it carries as compared to the "transfer fee covenant" term used in this article or the more negative "Home Resale Fees" used by the Coalition. See The Issue, COALITION, supra note 60; FREEHOLD CAPITAL PARTNERS, supra note 2.
64. N.C. GEN. STAT. § 39A (Supp. 2010); Heavens, supra note 34; see Fava, supra note 14 (describing the lobbying efforts by the Coalition in several states to prohibit TFCs). As of August 2011, three more states had passed laws prohibiting or restricting the use of TFCs, bringing the total to thirty-six. See Map, COALITION, supra note 7; North Dakota Becomes 27th State to Restrict Wall Street Home Resale Fees, COALITION TO STOP WALL STREET HOME RESALE FEES (Apr. 26, 2011), http://www.stophomeresealefees.org/north-dakota-becomes-27th-state-restrict-wall-street-home-resale-fees.
66. See § 39A (Supp. 2010).
67. Paul Johnson, New Law Bans Real Estate Transfer Royalty Fees, HIGH POINT ENTERPRISE, July 9, 2010, available at http://www.hpe.com/view/full_story/8616038/article-New-law-bans-real-estate-transfer-royalty-fees?instance=main_article. State Senator Katie Dorsett, of Guilford County, said she "felt [the ban on TFCs] was something that would be good public policy," adding that homeowners "shouldn't have to pay that fee forever." Id. A spokesman for the N.C. Justice Center added that TFCs are a "deceitful practice ... one that's not been common in the real estate markets in the United States historically. It hurts consumers and real estate values." Id. These comments mirror those of legislators in other states where TFCs have recently been banned. In Michigan, a state representative described TFCs as "utter nonsense that strips away hard-earned equity from homeowners." Aaron Kessler, U.S. Out to Curb Resale Fees, SARASOTA HERALD TRIB., Sept. 20, 2010, at D9. Similarly in Pennsylvania, State Representative Sue Helm described
criticize the Coalition for acting with self-interested motives and questionable tactics, their push to ban private TFCs has support from the legal community as well as government agencies and the common law.

A. An Explanation of North Carolina's Statute

The North Carolina TFC prohibition statute begins by stating that the public policy of the state "favors the marketability of real property and the transferability of interests in real property free from title defects, unreasonable restraints on alienation, and covenants or servitudes that do not touch and concern the property." It goes on to state that "transfer fee covenant[s]" violate the public policy of North Carolina by "impairing the marketability of title to the affected real property" and constitute an "unreasonable restraint on alienation and transferability of property, regardless of the duration of the covenant or the amount of the transfer fee set forth in the covenant."
Subsection two of section 39A defines many of the terms in the statute. First, the statute defines a “transfer fee” as a fee payable upon the transfer of an interest in real property that may be expressed as a fixed amount or a percentage. A “transfer fee covenant” is simply a declaration purporting to require the payment of a transfer fee to the declarant upon the subsequent transfer of an interest in real property. From this broad definition, the statute carves out several important exceptions, stating clearly what will not be considered a transfer fee under the new statute. Several of the exceptions can be summarized as the fees typically paid upon closing in addition to the purchase price, such as the real estate broker’s commission, attorney’s fees, and title insurance premiums. In addition to these expected exceptions, the statute also exempts “[a]ny reasonable fee payable by the original transferee to a unit owners’ association . . . as long as no portion of the fee is required to be passed through to a third party” and “[a]ny fee payable as part of a conservation or preservation agreement . . . .”

Having defined what a TFC is and is not under the statute, section 39A states that any TFC or lien filed to enforce a TFC “shall not run with the title to real property and is not binding on or enforceable at law or in equity . . . .” Furthermore, any person who records a TFC or files a lien to secure payment of the TFC shall be liable for any fees and damages that result from the TFC’s presence. Finally, the statute applies prospectively to any TFC recorded or lien filed after the effective date, July 1, 2010. Importantly, the General Assembly makes clear that “[n]othing in this act shall be interpreted to mean that a transfer fee covenant recorded prior to the effective date of this act is valid or enforceable.”

73. § 39A-2 (Supp. 2010).
74. § 39A-2(2) (Supp. 2010).
75. § 39A-2(3) (Supp. 2010).
76. § 39A-2(2)(a)–(j) (Supp. 2010).
77. See § 39A-2(2) (Supp. 2010).
79. § 39A-3(a) (Supp. 2010).
80. § 39A-3(b) (Supp. 2010).
B. Putting the Statute in Perspective

The statement of public policy relating to real property found in section 39A is not actually a statement of public policy, but a restatement of North Carolina's policy toward real property found in the 1973 Real Property Marketable Title Act. In 1973, the legislature made it clear that all land in North Carolina should be "made freely alienable and marketable," a sentiment that is reflected in the 2010 public policy statement that "this State favors the marketability of real property and the transferability of interests in real property free from title defects." Following the statement of public policy, section 39A lists the reasons why a TFC violates the state's policy—the covenants "impair[] the marketability of title" and constitute an unreasonable restraint on the transferability of property, regardless of the amount of the fee or the duration of the covenant. This language closely resembles the 1973 statement of public policy that said, "[n]onpossessory interests in real property . . . are prolific producers of litigation to clear and quiet title." Litigation impairs the marketability of title, and "cause[s] delays in real property transactions," thus restraining its transferability. As will be shown below, the modern TFC is clearly a "nonpossessory interest[] in real property" of the type described in the 1973 policy statement. Thus, even though the 2010 statement of policy was written as a direct response to the question of TFCs, it does not differ greatly, if at all, from the existing public policy regarding real property.

This consistency between the policy statements could prove to be important in a case where the enforceability of a pre-2010 TFC is challenged in court, as the Act explicitly states that it is not to be applied retroactively. In addition to maintaining the same public

84. § 47B-1(1); § 39A-1(a) (Supp. 2010). Black's Law Dictionary defines alienable as "[c]apable of being transferred to the ownership of another; transferable." BLACK'S LAW DICTIONARY 84 (9th ed. 2009).
85. § 39A-1(b) (Supp. 2010).
86. § 47B-1(2) to -(3).
87. Compare § 47B-1(3) (describing nonpossessory interests in property as restraining the marketability of property by producing litigation that delays real property transactions), with § 39A-1(b) (Supp. 2010) (describing TFCs as impairing marketability and imposing unreasonable restraints on the alienation and transferability of real property in a similar manner as § 47B-1).
88. § 47B-1(2); see infra note 135 and accompanying text.
policy stance as before, the General Assembly offers courts guidance when considering the validity of pre-existing TFCs by stating "[n]othing in this act shall be interpreted to mean that a transfer fee covenant recorded prior to the effective date of this act is valid or enforceable." This language suggests that the General Assembly did not believe a TFC should have been found valid or enforceable even before the new law took effect. Additionally, the Act states that the statute is effective against "any TFC that is recorded after the effective day of this act; [and] (ii) any lien that is filed to enforce a [TFC] that is recorded after the effective date of this act." Based on the structure of this sentence, it appears that the drafters intended for a lien recorded after the enactment to be unenforceable. This claim is bolstered by section 39A-3(a), which states that "[a]ny TFC or any lien that is filed to enforce a [TFC] ... is not binding on or enforceable at law or in equity against any subsequent owner, purchaser, or mortgagee ...." Furthermore, the Act explicitly creates liability for damages against "[a] person who records a [TFC] and anyone who "files a lien ... to secure payment of a transfer fee." Thus, section 39A will likely preclude judicial enforcement of pre-existing TFCs in addition to all future TFCs.

While the public policy behind the new statute is important, the definition of "transfer fee" represents a choice by the General Assembly to allow certain traditionally accepted covenants and fees while prohibiting TFCs. Within the definition of what is a transfer fee are several clear statements of what is not considered a transfer fee. Among these, there are two exceptions that differ substantially from the typical real estate transaction fees—a fee payable to an owners' association (so long as no portion of the fee is required to go through a third party) and a fee payable as part of a conservation or preservation agreement. These two exceptions are recommended by

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91. See Burti, supra note 89 (noting that it was the General Assembly's "clear intent not to validate such covenants").
93. See Burti, supra note 89 (recognizing "that filing a lien to enforce a pre-existing covenant after the effective date of the act may be prohibited").
95. § 39A-3(b) (Supp. 2010).
97. Id.
the NAR/ALTA Model Private Transfer Fee statute and can be found in the TFC-banning statutes of several other states— including Illinois, Ohio, Arizona, and Washington. These covenants, especially ones that might impose a transfer fee payable to an owners’ association for the purpose of financing association operations and/or maintenance of common amenities, would typically have satisfied the common law’s “touch and concern” standard, which is explicitly referenced in section 39A-1(a), as well as in the model statute presented by the NAR/ALTA. By following the model statute proposed by the NAR and ALTA, North Carolina effectively resolved the legal and public policy concerns surrounding TFCs while still allowing for TFCs to be used to benefit community associations. A statute that simply banned all TFCs would not allow owners’ associations to utilize this valuable source of funding, which associations have used for more than a decade to fund their operating budgets, capital projects, and reserve funds. North Carolina has

99. See Freyermuth, supra note 5, at 25 (noting that section 1(a)(4)(C)-(D) of the model statute exempts association fees and environmental covenants from the definition of a transfer fee).
100. 765 ILL. COMP. STAT. 155/10 (2011).
101. FLA. STAT. ANN. § 689.28(c)(7)-(10) (West Supp. 2011).
103. ARIZ. REV. STAT. ANN. § 33-442(C)(3) (Supp. 2010).
104. 2011 Wash. Sess. Laws 398. Several other states exempt homeowners’ associations from the TFC definition but not environmental covenants or conservation agreements. See, e.g., MD. CODE ANN., REAL PROP. § 10-708 (West 2011); MINN. STAT. § 513.73 (2011); OR. REV. STAT. § 93.269 (2011); TEX. PROP. CODE ANN. § 5.107 (West 2011); UTAH CODE ANN. § 57-1-46 (West 2011).
105. See N.C. GEN. STAT. § 39A-1(a) (Supp. 2010) (proclaiming a public policy interest against “covenants or servitudes that do not touch and concern the property”). The part of the NAR/ALTA model statute section referred to is section 1(b)(1): “[t]he public policy of this State favors the transferability of interests in real property free from . . . covenants or servitudes that do not touch and concern the property.” Freyermuth, supra note 5, at 25 (emphasis added).
106. CMTY. ASS'NS INST., supra note 11, at 1. A survey was conducted by the Community Associations Institute ("CAI"), a membership organization representing the interests of more than sixty million community association members across the United States. Id. It was conducted largely in response to the recent FHFA guidance that proposed to prohibit federal home loan banks from investing in any mortgage encumbered by a TFC, including one that goes directly to an owners’ association. Id.; Private Transfer Fee Covenants, 75 Fed. Reg. 49,932, 49,933–34 (Aug. 16, 2010). As an example, look no further than the battle over transfer fees in Hawaii in 2009. As a response to a call for comments on transfer fee legislation that was arguably overbroad or unclear in its definition of what would and would not be considered a transfer fee, the co-chair of the Hawaii Legislative Action Committee ("LAC") of the CAI wrote that the LAC supports the intent and purpose of [the proposed legislation] to prevent developers from using so-called transfer fees from every future sale of homes and apartments in common interest communities as a “cash cow" to generate income.
struck a balance by eliminating TFCs that benefit only private third parties while allowing traditional\textsuperscript{107} uses of TFCs to continue.

The plain language of North Carolina’s recent statute clearly prohibits the use of TFCs going forward\textsuperscript{108}. It is also likely that the statute will be interpreted as invalidating pre-existing TFCs.\textsuperscript{109} Even so, in the event that courts are asked to evaluate the validity of a TFC, they would not need to rely on an overly technical reading of the statute or legislative intent to find a TFC to be unenforceable. This is because the statute, by reiterating the pre-existing public policy of the state and reemphasizing the importance of the “touch and concern” standard,\textsuperscript{110} codifies common law property principles, prohibiting the future use of a covenant that would likely have been found unenforceable at law and against public policy.

III. Transfer Fee Covenants Are Unenforceable at Law

The entire premise of the TFC model is based on the assumption that a buyer will voluntarily pay the one percent fee when reselling the home or be forced to pay it in order to remove a lien imposed by the trustee of the TFC.\textsuperscript{111} However, if the TFC is not legally enforceable, there is nothing preventing a future buyer from simply ignoring the TFC in the title and refusing to pay the one percent fee to the trustee. Before the recent wave of legislation prohibiting private TFCs,\textsuperscript{112} the enforceability of a TFC had not been challenged in any court. The validity of a TFC may remain a question in states that have not banned the instrument, as well as in cases addressing pre-existing TFCs in states that have banned the future use of TFCs,
such as North Carolina. Because the prohibitive statutes are not applicable retroactively, the principal legal challenge to the already existing TFCs is that the covenant does not “touch and concern” the land.

A. A Brief History of the “Touch and Concern” Standard in North Carolina

Under common law principles, a covenant did not “bind a successor to the original covenantor unless both the benefit and the burden of the covenant ‘touched and concerned’ land.” This principle was famously set out in Neponsit Property Owners’ Ass’n v. Emigrant Industrial Savings Bank, where both the benefit and burden of an affirmative covenant to pay money for the upkeep of roads and parks in the community were said to touch and concern the land, and thus were found to “run with the land” and bind the subsequent property owners to perform the covenant. Today, similar covenants are typically found in homeowners’ association lot assessment covenants, where each lot in a community is required to pay a sum to fund the operation of the association that maintains common facilities. Since Neponsit was decided in 1938, challenges to “lot assessment covenants” have failed, as most courts regularly find both the “benefit and the burden” to “touch and concern the land”—a finding that requires subsequent owners of the land to abide by the covenant.

Just as in Neponsit, North Carolina law requires that, for a real covenant to run with the land, both the benefit and the burden must touch and concern the land. If both the benefit and burden do not

113. See supra notes 89–95 and accompanying text (describing the likelihood that a pre-existing TFC would not be found valid based on the language of the North Carolina statute). However, there are those who believe that the statute does not affect TFCs that predate the 2010 statute. See Michael Hunter, N.C. Law Banning Transfer Fees is Questioned, THE CHARLOTTE OBSERVER, Sept. 11, 2010, at H2 (“[A] plain reading of the wording of [section 39A] leads me to believe that the ban is not retroactive, and that transfer fees contained in [covenants, conditions, and restrictions] recorded before July 1, 2010 are still legal and may be enforced by filing a lien against the subject property if the fee is not paid at closing.”).

114. Bardwell & Durham, supra note 2, at 29.
115. Freyermuth, supra note 5, at 21.
116. 15 N.E.2d 793 (N.Y. 1938).
117. Id. at 797.
118. Freyermuth, supra note 5, at 21.
119. Id. at 22.
touch and concern the land, the covenant is deemed a personal covenant, which does not bind successors to the original covenantor. The North Carolina Court of Appeals recently applied the “touch and concern standard” in *MidSouth Golf, L.L.C. v. Fairfield Harbourside Condominium Ass’n*. The court held that an amenity fee covenant, which required homeowners to pay a fee for recreational facilities regardless of their use of said facilities, did not benefit the homeowners’ land and thus did not touch and concern the land. The court in *MidSouth* took much of its language from an earlier decision, *Raintree Corp. v. Rowe*. There, the court held that an affirmative covenant to pay country club dues, the facilities of which were not “connected with, or attached to the [homeowners’] land in any way,” was not connected with the homeowners’ use of the land and thus did not touch and concern the land. Both cases reinforce the theme that an affirmative covenant to pay money that does not benefit the land will not be found to touch and concern the land.

**B. The Application of North Carolina’s “Touch and Concern” Standard to the TFC Model**

TFCs are not “lot assessment covenant[s]” like the type envisioned in *Neponsit*. The TFC model proposed by Freehold is payable only to private third parties, not to a homeowners’ association. In the TFC model, the covenant purports to bind subsequent owners to pay a one percent transfer fee, the burden, which will benefit the developer, licensor, and trustee. This aspect

121. *Id.* at 30, 652 S.E.2d at 384.
123. 187 N.C. App. at 32–38, 652 S.E.2d at 385–89.
124. *Id.* at 36, 652 S.E.2d at 388.
126. *Id.* at 670, 248 S.E.2d at 908–09.
127. See *Snipes, supra* note 23, at 5.
129. *Id.*; see also *FREEHOLD CAPITAL PARTNERS, supra* note 2 (describing the process by which “you,” the developer, receive income from future sales, which you may either keep or sell on the common markets).
130. See Freyermuth, *supra* note 5, at 22; *Snipes, supra* note 23, at 5. It is likely that the proponents of the TFC model would argue that by requiring that five percent of the transfer fee be donated to a local charity or nonprofit, the TFC is in fact benefiting the community. *Snipes, supra* note 23, at 5. However, as the charity or nonprofit is not required to actually benefit the specific lot, the subdivision, or even the city in which the
of the TFC makes it less like a real covenant, which runs with the land, and more like a personal covenant, which does not.\textsuperscript{131} Like in \textit{MidSouth} and \textit{Raintree}, fees due under a TFC are not connected with the land.\textsuperscript{132} The benefit received by the initial owner of the property encumbered by the TFC is that, presumably, the purchase price is discounted to reflect the presence of the TFC.\textsuperscript{133} However, these savings are likely to be lost when the initial owner is forced to lower the purchase price for the next buyer, in order to reflect the presence of the TFC.\textsuperscript{134} The burden of the one percent fee would run with the land, but the benefit would remain with the developer, licensor, and trustee, as each subsequent buyer would receive the same "benefit" of buying low and then selling low, in addition to the one percent fee future buyers would pay to the beneficiaries of the TFC.\textsuperscript{135}

The statement of public policy found in section 39A-1(a) explicitly states that covenants or servitudes that do not "touch and concern the property" are to be disfavored.\textsuperscript{136} This seems to indicate that the General Assembly intends for the courts to apply the common law "touch and concern" standard, as opposed to the more modern contract-oriented approach favored by the \textit{Restatement (Third) of Property}.\textsuperscript{137} Section 39A's restatement of public policy, combined with the established case law of North Carolina, suggest a North Carolina court would likely find a TFC to be a personal covenant, enforceable only between the initial covenantor and covenantee, which does not run with the land.\textsuperscript{138} The TFC model claims to be a "true win-win scenario" for developers and homeowners.\textsuperscript{139} However, it is the developer, licensor, and trustee group that are attempting to win twice by keeping the benefit of the fee while retaining none of the burden.\textsuperscript{140}

\textsuperscript{131} \textit{MidSouth Golf, L.L.C. v. Fairfield Harbourside Condo. Ass'n}, 187 N.C. App. 22, 30, 652 S.E.2d 378, 384 (2007) (finding a covenant that did not touch and concern the land was not a real covenant and did not run with the land as intended).

\textsuperscript{132} \textit{Snipes, supra} note 23, at 5.

\textsuperscript{133} \textit{See FREEHOLD CAPITAL PARTNERS, supra} note 2.

\textsuperscript{134} \textit{See Snipes, supra} note 23, at 3.

\textsuperscript{135} \textit{See id.; Freyermuth, supra} note 5, at 22.

\textsuperscript{136} N.C. GEN. STAT. § 39A-1(a) (Supp. 2010).

\textsuperscript{137} § 39A-1(a) (Supp. 2010); \textit{RESTATEMENT (THIRD) OF PROP.: SERVITUDES} §§ 3.1–3.2 (2000); \textit{see infra} Part III.C. for a discussion of the new standard suggested by the \textit{Restatement (Third) of Property: Servitudes}.

\textsuperscript{138} \textit{See Freyermuth, supra} note 5, at 22; \textit{Snipes, supra} note 23, at 5.

\textsuperscript{139} \textit{FREEHOLD CAPITAL PARTNERS, supra} note 2.

\textsuperscript{140} \textit{See Freyermuth, supra} note 5, at 22; \textit{Snipes, supra} note 23, at 5.
C. The Restatement (Third) of Property and the "Touch and Concern" Standard

The preceding analysis depends upon a court following the traditional "touch and concern" standard, to which North Carolina has adhered as recently as 2007.\footnote{141} However, the 2000 Restatement (Third) of Property: Servitudes explicitly supersedes the "touch and concern" doctrine, stating that "[n]either the burden nor the benefit of a covenant is required to touch or concern land in order for the covenant to be valid as a servitude."\footnote{142} Instead, a servitude will be valid unless it is illegal or unconstitutional or violates public policy. Servitudes that are invalid because they violate public policy include, but are not limited to: (1) a servitude that is arbitrary, spiteful, or capricious; (2) a servitude that unreasonably burdens a fundamental constitutional right; (3) a servitude that imposes an unreasonable restraint on alienation under § 3.4 or § 3.5 [of this Restatement]; (4) a servitude that imposes an unreasonable restraint on trade or competition under § 3.6 [of this Restatement]; and (5) a servitude that is unconscionable under § 3.7 [of this Restatement].\footnote{143}

Essentially, the supersedure of the "touch and concern" standard reformulates the initial inquiry and shifts the burden.\footnote{144} Under the current Restatement, the inquiry is whether the covenant violates public policy, and the burden is on the party claiming the violation to show that the covenant is one that should not run with the land.\footnote{145} The changes to the Restatement reflect the real reason most courts have been striking down covenants under the "touch and concern" standard—they found them to be against public policy.\footnote{146}

Supporters of the TFC model point to the Restatement for support.\footnote{147} The Restatement abandons the common law "touch and concern" standard in favor of contract principles.\footnote{148} Under the new

\footnote{141. See supra Part III.A. In the statement of public policy found in section 39A-1, the North Carolina General Assembly reiterated its preference that covenants touch and concern the land. § 39A-1(a) (Supp. 2010). However, other jurisdictions may follow the Restatement (Third) more literally, where section 3.1 would have additional importance. See infra note 143 and accompanying text.}
\footnote{142. RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.2(2000).}
\footnote{143. Id. § 3.1 (emphasis added).}
\footnote{144. Id. § 3.2 cmt. a.}
\footnote{145. Id.}
\footnote{146. Id. § 3.2 cmt. b.}
\footnote{147. Freyermuth, supra note 5, at 22.}
“reasonableness” standard set out in section 3.1, a covenant that only imposes an indirect restraint on alienation does not unreasonably restrain alienability unless it lacks “rational justification.” TFC advocates such as Freehold have utilized this language, claiming that TFCs are “reasonable,” a de minimis one percent fee that has no practical burden on alienability, and “rational,” as the TFC benefits both the developer and the buyer. Therefore, in the opinion of Freehold and its allies, a TFC-type servitude that meets general contract requirements will be presumptively valid unless the covenant is illegal, unconstitutional, or against public policy.

This premise could be tested in states where the courts have replaced the traditional “touch and concern” analysis with the Restatement’s new emphasis on public policy, provided that there is no statutory prohibition against TFCs. In states where future TFCs are prohibited, like North Carolina, courts may be required to assess Freehold’s public policy argument in a challenge to enforce a pre-existing TFC. In North Carolina, this challenge would likely be resolved using the “touch and concern” standard, as it does not appear that North Carolina courts have adopted the Restatement’s approach to the “touch and concern” standard, especially

/ story/2010030513591300043.pnw/topstory.html.

149. For example, such a covenant would limit the number of potential buyers or reduce the amount for which the owner will be able to sell the property. Restatement (Third) of Prop.: Servitudes § 3.5 cmt. a (2000).

150. Freyermuth, supra note 5, at 22.

151. Id.

152. A restrictive covenant such as a TFC would be governed by the statute of frauds, which requires that contracts to sell or convey real property be reduced to writing. N.C. Gen. Stat. § 22-2 (Supp. 2010). Thus, the formalities can be analogized to “[a] contract for the sale of real property” which “must meet the following requirements: be in writing; signed by the parties; contain an adequate description of the real property; recite a sum of consideration; and contain all key terms and conditions of the agreement.” Rawls & Assoc. v. Hurst, 144 N.C. App. 286, 290, 550 S.E.2d 219, 223 (2001); see also Press Release, RJon Robins, supra note 148 (arguing that a TFC meets the general requirements of a contract and thus should be valid unless shown to be “illegal, unconstitutional, or against public policy”).


155. The general validity of a pre-existing TFC could still be questioned in North Carolina as well as any of the other states that prohibit future TFCs and any of the fourteen states that have not enacted statutory prohibitions of the TFC practice. See supra notes 89–95 and accompanying text.

considering recent Court of Appeals decisions\textsuperscript{157} and statutory language\textsuperscript{158} that suggest the traditional "touch and concern" analysis is still applicable in North Carolina. That said, public policy reasons have long been behind "touch and concern" analysis,\textsuperscript{159} and a court, in North Carolina or elsewhere, may be required to determine whether TFCs should be void as to public policy.

\section*{IV. Transfer Fee Covenants Are Against Public Policy}

If a TFC is challenged in a jurisdiction that takes the more modern approach of the \textit{Restatement (Third) of Property}, the inquiry is shifted from the amorphous "touch and concern" standard to whether the covenant is against public policy.\textsuperscript{160} North Carolina first stated its public policy on transactions of real property in the 1973 Real Property Marketable Title Act.\textsuperscript{161} The themes of this Act were reemphasized in the 2010 Transfer Fee Covenants Prohibited Act.\textsuperscript{162} Combining these two statements of public policy, it is clear that the State of North Carolina favors land that is "freely alienable and marketable" and disfavors nonpossessory interests with lengthy terms that lead to litigation to quiet title, which ultimately cause delays in the transfer of property.\textsuperscript{163} The policy against restraints on alienation is based upon the belief that "restraints remove property from commerce, concentrate wealth, prejudice creditors, and discourage property improvements."

In most circumstances, covenants that restrain the alienation of real property are "void" under North Carolina law.\textsuperscript{165} As the TFC

\textsuperscript{157} See MidSouth Golf, L.L.C. v. Fairfield Harbourside Condo. Ass'n, 187 N.C. App. 22, 30, 652 S.E.2d 378, 384 (2007) (refusing to enforce a covenant that did not touch and concern the land).  
\textsuperscript{158} Transfer Fee Covenants Prohibited Act of 2010, 2010 N.C. Sess. Laws 245 (codified at N.C. GEN. STAT. § 39A (Supp. 2010)).  
\textsuperscript{159} \textit{Restatement (Third) of Property: Servitudes} § 3.2 cmt. b (2000).  
\textsuperscript{160} \textit{Restatement (Third) of Property: Servitudes} §§ 3.1–3.2.  
\textsuperscript{162} 2010 N.C. Sess. Laws 245. For a discussion of the similarities between the two acts, see \textit{supra} Part II.B.  
\textsuperscript{165} \textit{Id.} at 623–24, 224 S.E.2d at 583.
model has just recently come to North Carolina,\textsuperscript{166} it has yet to be directly challenged in the courts.\textsuperscript{167} Nevertheless, as suggested above, if the covenant were to be challenged directly, it is likely that it would be found invalid because it does not touch and concern the land.\textsuperscript{168}

In North Carolina, it is unlikely that the courts would defer to the Restatement's new rule over their own traditional conception of the "touch and concern" requirement.\textsuperscript{169} Under this inquiry, which the Restatement itself suggests has been behind many past findings of invalidity,\textsuperscript{170} TFCs would still be unenforceable because they are against public policy, particularly in North Carolina.\textsuperscript{171} However, if a court were following the Restatement's emphasis on the public policy inquiry, there remain several reasons why a TFC could be found to be against public policy, among them that the instrument restrains the alienability of real property.

A. Inadequate Disclosure of Transfer Fee Covenants

In the majority of cases, the TFC is located within the dozens, or more often hundreds, of pages of documents that buyers sign at a closing.\textsuperscript{172} If the TFC is not disclosed to the buyer until closing, it is unlikely that the buyer would simply be able to walk away from the transaction upon such disclosure.\textsuperscript{173} In this situation, the TFC has taken the buyer by surprise, making it impossible for him to use it to negotiate a better price, which is suggested as one of the "benefits" of the TFC model.\textsuperscript{174} Even if the TFC is properly disclosed, homebuyers are so "'inundated with disclosures when they buy'" that they "'usually do not know what documents are important.'"\textsuperscript{175} If the homebuyer does not understand the effect of the disclosed covenants, the effect is just the same as if the covenant had been concealed,
which does happen. In either case, "[t]he fee will probably be just a surprise when [the homeowners] decide to sell," and the TFC shows up on their title search. The de facto surprise fee has many realtors and title insurance companies worried that homeowners will find it nearly "impossible ... to get free and clear title," which restrains the alienability and transferability of the home.

B. Inability to "Price" the Effect of the Transfer Fee Covenant

Even if the buyer is made aware of the TFC well before closing and is able to use that knowledge to negotiate a more favorable price, she may not appreciate exactly how expensive that one percent fee will someday be—it is a percentage of the total value of the home, whether the value goes up or down in the future. The "rational buyer" explanation for the TFC model assumes that the covenant will be discovered and understood by the buyer. From this understanding the "rational buyer" will adjust her offer price to reflect lower perceived value due to the presence of the TFC. However, this assumption presents many problems. First, because the future TFC payment is based on the future value of the land, the buyer must be able to calculate current dollar amount of the expected future value of the land to determine how much to reduce her offer to account for the presence of the TFC. Second, for the buyer to determine the future value of her property, she must know how long she plans to live on that property. The amount the purchase price

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176. See Snipes, supra note 23, at 3 (explaining the consequences of not disclosing a TFC or any other covenant for that matter).  
177. Waters, supra note 6 (quoting Rick Akin, real estate attorney); see also Morrissey, supra note 1 (providing an example of a couple who knew nothing about the fee when they purchased their home).  
178. Stephanie Fitch, Proponent of New Real Estate Fee Exempts His Own House, FORBES.COM (Aug. 24, 2010), http://www.forbes.com/2010/08/24/new-real-estate-fees-personal-finance-reconveyance-fees.html. It is notable that California, the only state to have taken legislative action that actually permits the use of TFCs in residential real estate, requires significant and specific disclosure procedures when TFCs are used. CAL. CIV. CODE § 1098.5 (West 2011). Even Freehold recognizes the "need for adequate disclosure" when implementing the TFC instrument. Press Release, Freehold Licensing Comments on California Assembly Bill 980 (Aug. 26, 2008) (quoting Michael Gagne, Freehold Licensing Vice President), available at http://www.thefreelibrary.com/Freehold+Licensing+Comments+on+California+Assembly+Bill+980.-a0183854881.  
179. Fitch, supra note 178.  
180. See supra notes 43–47 and accompanying text.  
181. Freyermuth, supra note 5, at 23.  
182. Id.  
184. Id. at 457–58.
should be adjusted will vary greatly for a buyer who plans to resell a house in two years versus a buyer who plans to live in the house for forty years.\textsuperscript{185} However, when the initial buyer does resell the property, she will likely need to do so at a discount in order to compete with other sellers of unencumbered property, thus losing any initial savings gained from the discounted purchase price.\textsuperscript{186} Finally, and perhaps most importantly, buyers have little assurance that the seller has actually reduced the present purchase price to reflect the presence of the TFC.\textsuperscript{187} If the TFC is presented as a "take it or leave it" option, the buyer does not have a "meaningful 'covenant or no covenant' choice."\textsuperscript{188} This problem is compounded by the lack of comparable covenant-less properties nearby for the buyer to use as a "baseline" when evaluating the final price of a home with a TFC.\textsuperscript{189}

C. Transfer Fee Covenants Impermissibly Restrain Alienation

A lack of adequate disclosure and the inability of buyers to accurately price the effect of the TFC will undoubtedly lead to additional transaction costs, which "impede future land transactions."\textsuperscript{190} These costs could be associated with the process of finding and paying the trustee who holds the transfer fee right or perhaps tracking down the developer to pay him directly.\textsuperscript{191} Also, the seller and buyer will spend time and money negotiating who will pay the actual transfer fee at the time of the sale.\textsuperscript{192} The seller will also face the ethical, and financial, choice of whether or not to disclose the presence of the TFC.\textsuperscript{193} These extra costs would tend to limit the owner's "ability to convey," which is one of the key elements in a finding that a covenant imposes an "impermissible restraint on alienation."\textsuperscript{194}

Nevertheless, not all restraints on alienation are impermissible. The \textit{Restatement (Third) of Property: Servitudes} takes the position

\begin{itemize}
\item \textsuperscript{185} \textit{Id.}
\item \textsuperscript{186} Snipes, \textit{supra} note 23, at 3; \textit{see also} Harney, \textit{supra} note 28 (explaining that sellers may have to sell for less if the home is encumbered by a TFC).
\item \textsuperscript{187} Freyermuth, \textit{supra} note 183, at 458.
\item \textsuperscript{188} Freyermuth, \textit{supra} note 5, at 23.
\item \textsuperscript{189} \textit{Id.}
\item \textsuperscript{190} Freyermuth, \textit{supra} note 183, at 461; \textit{see also} Snipes, \textit{supra} note 23, at 3 (describing the practical effects of TFCs that implicitly lead to increased transaction costs).
\item \textsuperscript{191} Freyermuth, \textit{supra} note 5, at 23.
\item \textsuperscript{192} \textit{Id.; see also} Harney, \textit{supra} note 28 (describing the effects of TFCs on home owners and buyers alike).
\item \textsuperscript{193} Freyermuth, \textit{supra} note 5, at 23.
\item \textsuperscript{194} Bardwell & Durham, \textit{supra} note 2, at 28.
\end{itemize}
that two parties should be allowed the freedom to contract to any servitude arrangement they desire, so long as it is not "unconscionable and does not otherwise violate public policy." As stated in one North Carolina Supreme Court decision, such restraint is permissible "if the objectives behind the imposition of the restraint are sufficiently important to outweigh the social evils which flow from the enforcement of the restraint or if the interference with the power of alienation is so insignificant that no appreciable harm results from the enforcement of the restraint." Using this rationale, the "benefit" of the TFC to society—if there is any—is not greater than the "social evils" of increased transaction costs and decreased resale values of property.

In sum, it is likely that a court would find a TFC to be against public policy and therefore an unenforceable covenant. TFCs are nonpossessory interests that benefit unrelated private third parties. They increase the total cost of owning a home, which in turn limits the transferability of property. They further complicate the sale of residential property and could lead to legal uncertainty. They will likely discourage homeowners from making property improvements that increase the home's value, as that increase in value will translate into an increase in the fee paid to the third party beneficiary. The homeowners know they would be "obliged to share that appreciation, via the [transfer fee], with people who didn't contribute at all." Furthermore, because TFCs reduce the resale price of affected property, the community tax base is lowered, which reduces the total amount of money available for a city or town to fund its public programs. Finally, the Federal Housing Finance Agency has stated in a proposed guidance that the "[e]xpanded use of private transfer fee covenants poses serious risks to the stability and

195. Restatement (Third) of Prop.: Servitudes § 3.5 cmt. a (2000).
197. See generally Snipes, supra note 23 (enumerating practical drawbacks of TFCs and legal issues that arise).
199. Id. at 49,933.
200. Id.
202. Fitch, supra note 178 (quoting Kelly Lise Murray, Professor, Vanderbilt School of Law).
203. See supra note 46 and accompanying text.
204. Freyermuth, supra note 5, at 23-24.
liquidity of the housing finance markets." This agency statement is in line with the stated public policy of North Carolina that real property should be "freely alienable and marketable," characterized as efficient transactions and not delayed by unnecessary investigation or litigation related to nonpossessory interests that purport to run with the property for an extended amount of time.

CONCLUSION

State legislatures across the nation are acting to halt the use of TFCs. But the North Carolina General Assembly was not simply swept up in the furor of national legislative activity. Rather, the North Carolina General Assembly made a conscious decision to strengthen common law property principles by explicitly prohibiting private transfer fee covenants. Section 39A of the General Statutes of North Carolina represents a continuation of the common law property principles already present in the state. The General Assembly banned lucrative private TFCs, which benefit only private third parties, while carving out an exception for owners' associations and environmental covenants. These two exceptions preserve the traditional uses of TFCs as funding for homeowners' associations as well as conservation easements. By codifying these principles as a response to the specific threat posed by the TFC model, the North Carolina General Assembly strengthened the common law via statute and instructed North Carolina courts to enforce the public policy of the state by rejecting pre-existing TFCs.

CHRISTOPHER D. McEACHRAN

205. 75 Fed. Reg. at 49,933.
207. See Map, COALITION, supra note 7.
209. See supra note 78 and accompanying text.

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