HYATT & STUBBLEFIELD, P.C.

The Client Letter

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This newsletter addresses current issues and developments in the law relating to development of planned communities. It is published periodically for distribution to clients and friends of Hyatt & Stubblefield, P.C., Attorneys and Counselors. The information presented is not intended as specific legal advice to any person. Principles of law expressed in this newsletter are subject to change from time to time.

Developing Dynamic Communities with Transfer Fees

What do Celebration in Florida, Spring Island in South Carolina, and The Landings at Skidaway Island in Georgia have in common? In addition to being examples of award-winning, diverse, and dynamic communities that set the standard for community planning and environmental stewardship, each of these communities utilizes transfer fees as a financial tool to create activities and programs that make these communities unique places where people want to live. Developers should be leery, however, of companies selling for-profit transfer fee schemes.

Transfer fees are charged when an owner sells his or her property. Sometimes transfer fees are imposed at the time of the original sale from the developer/builder to the first property owner and upon all subsequent sales. Sometimes the initial transfer from developer/builder to the first property owner is exempt.

There are two primary purposes for transfer fees. First, they may be used to compensate the community association for administrative expenses associated with the sale (for example, updating membership and mailing lists). Second, they can provide a convenient means of raising additional revenue for operating funds, common area reserve funds, and for special community programs, such as environmental, historical, cultural, educational, and community activities and programs. We have seen transfer fees used to fund a welcome program for new residents, fund community-building events such as an annual Independence Day parade, provide grants to local schools and Boys & Girls Clubs, manage and protect nature preserves, fields, and wildlife on the property, and fund educational, artistic, and cultural programs and partnerships, including partnerships with conservancies and other environmental organizations. We have also seen transfer fee monies used to market property in the community.

There are two common methods for computing transfer fees. Some communities use a flat rate or fixed fee, while others use a percentage of the sales price. When the fees are computed as a percentage of the sales price, they often range from 0.5% to 1.5% of the sales price of the property. Caution must be used when setting the transfer fee rate because high transfer fees could be considered excessive by the courts and found to be an invalid restraint against alienation of the property.

In this economy, some owners may balk at having a transfer fee charged on the sale of their home. Arguably, transfer fees place a burden on units that have lost value or are frequently sold since the seller does not have sufficient time to reap the benefits of property appreciation. However, the services and programs funded by transfer fees can add to the property's value, thus heightening the community's stability, property values, and marketability.

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Transfer fees are most effective and are more likely to be upheld by a court when they comply with a basic tenet of real property law — that any covenant running with the land must "touch and concern" the land if it is to be enforced against subsequent purchasers. This means that the transfer fee should effectively increase the use or utility of the land and/or make it more valuable. Some courts no longer use the "touch and concern" doctrine as a basis for determining whether or not a covenant is valid, but the Kansas, Florida, and Missouri legislatures recently passed bills making transfer fees in violation of this real property tenant void and unenforceable. 2009 *Kansas Laws Ch.* 14 (H.B. 2092); *Fla. Stat.* § 689.28, *et seq.* (2009)*; Rev. Stat. Mo.* § 442.558, *et seq.* (2009). Furthermore, a buyer in the community is more likely to understand and accept the transfer fee if the fee is used for purposes that add value to the community. This arrangement is also less likely to be seen as an unreasonable restraint on alienation.

State Regulation of Transfer Fees

Currently, most states do not regulate the use of transfer fees; however, a handful of states, including California, Florida, Kansas, Texas, and Missouri, have considered whether to allow transfer fees in real estate transactions and how to administer them. 2009 *Kansas Laws Ch.* 14 (H.B. 2092); *Fla. Stat.* § 689.28, *et seq.* (effective July 1, 2008)*; Mo. Rev. Stat.* § 442.558, *et seq.* (effective August 30, 2008); *Tex. Prop. Code* § 207.003, *et seq.* (effective September 1, 2009); *Cal Civ Code* § 1098, *et seq.* (effective January 1, 2008). In Texas, the legislature now requires homeowner associations to deliver to a property owner in the process of selling his or her property a certificate that states the amount of any transfer fee charged by the homeowners' association for a change of property ownership. The California legislature instituted a similar law that requires the person or entity imposing the transfer fee to record a document, in addition to the document that creates the transfer fee, which explains the transfer fee in detail to a prospective purchaser.

While transfer fees should be used to benefit the land upon which the fee is imposed and make it more valuable, some developers have abused transfer fees by creating transfer fees that result in an "annuity" for the developer who recorded the covenant creating the transfer fee. In that situation, even if the developer is no longer involved with the community or administering the transfer fee, and never uses the fee to benefit the burdened property or the property owner(s), the developer still receives the transfer fee, which is inconsistent with the "touch and concern" doctrine. Several companies have recently cropped up offering to set up such annuities for developers for a modest fee, but in certain states, such annuities are illegal. The Kansas, Florida, and Missouri legislatures have all recently passed bills making transfer fees in violation of the "touch and concern" principle void and unenforceable. 2009 *Kansas Laws Ch.* 14 (H.B. 2092); *Fla. Stat.* § 689.28, *et seq.* (2009)*; Mo. Rev. Stat.* § 442.558, *et seq.* (2009).

In passing its legislation, the Florida legislature explained that public policy favors the free marketability of real property and the transfer of property without unreasonable restraints on alienation. The legislature's concern is that transfer fees can violate this public policy by impairing the marketability and transferability of real property, by constituting an unreasonable restraint on alienation, and by violating common law and equitable principles.

While there are only a few states with statutes on transfer fees at present, all of the legislation has been enacted in the last two years, possibly indicating a growing trend that other states may soon follow.

In addition, at least one state court has struck down a fee because the fee violated the "touch and concern" principle. In 2005, an Arizona trial court struck down a covenant in a declaration of covenants, conditions, and restrictions ("CCRs") because the CCRs established an annual assessment of $40 per lot owner to support of the Rincon Institute, a nonprofit conservation organization serving the Rincon Valley near Tuscan, Arizona. While the case involved an annual assessment, instead of a transfer fee, it is relevant to the enforceability of transfer fees because the trial court struck down the fee because it violated the "touch and concern" doctrine. The court explained that, while the Rincon Institute creates and monitors trail activities, works with environmentalists for the protection of water and wildlife, and engages in activities to protect open space in the Rincon Valley, no area maintained by the Institute is contained within the subdivision burdened by the CCRs. While the trial court recognized that everyone benefits from preservation of the natural environment, the CCRs (and the associated fee) did not operate to benefit the lot owners in the use of their land, and therefore, violated the "touch and concern" principle. On this basis, the trial court found the $40 assessment against all lot owners to be invalid. This cased demonstrates that courts continue to enforce the "touch and concern" principle, and therefore, it is wise for transfer fees to adhere to this principle as well.

Beware of For-Profit Transfer Fee Schemes

In the past few years, several companies, including Freehold Licensing and Freehold Development, Inc., have begun marketing transfer fee services on a for-profit basis to developers. The company will prepare a transfer fee covenant to be recorded by the developer, as the owner of the property, against the land to be subdivided and sold as

lots or condominium units to consumers. The transfer fee covenant requires subsequent sellers to pay a transfer fee (typically 1% of the sales price) for nearly all transfers of the real estate for the next 99 years. Each time the transfer fee is paid, the fee is divided between the developer and the company. The sales pitch is that the transfer fee covenant can provide a revenue stream for the developer for decades to come.

Sound too good to be true? In all likelihood, it is for the reasons described above. Commonwealth Land Title Insurance Company and Lawyers Title Insurance Company, two of the most prominent title insurance companies in the country, recently issued underwriting policy statements that they would no longer issue title policies on property burdened by the type of transfer fee covenants produced by the Freehold company. The reasons for the change in policy cited by the title companies include questions about the validity and enforceability of such schemes due to the fact that a number of states have already deemed such transactions void, the fact that the covenants do not satisfy the touch and concern doctrine, and the possibility that the scheme could be against public policy or constitute an illegal private transfer tax.

Everyone Can Benefit if Properly Created

If created and administered in a way that benefits the community and property owners paying the fee, transfer fees can provide essential funding for community-building programs and activities. Since owners only pay the fee upon the sale of their property, they do not feel the same burden as with monthly, quarterly, or annual assessments. In addition, in situations where owners are long-term property owners, they benefit from the fee by being able to participate in community programs and activities and also reap the benefits of property appreciation. Developers benefit from the fee because it allows them to create unique places that people want to live, and communities benefit from the fee because the fee allows for programming and activities that may not be funded otherwise.

Frequently Asked Questions: Annual Meetings

Among the most frequently asked questions we receive are those involving the association's annual meeting. Here are a few of the more popular questions and our answers.

Is an annual meeting required? Yes. Almost all homeowners associations, condominium associations, and equity clubs are organized as nonprofit corporations. State corporate law usually requires that a nonprofit corporation conduct an annual meeting of its members each year.

What about during the declarant or developer control period when the developer is in control of the association? The requirement still applies. Developers should be extra cautious about satisfying meeting requirements during its period of control to avoid later complaints or claims by homeowners. While there may not be an election conducted at the annual meeting if owners do not yet have the right to elect directors, there is still other business that can be conducted at the meeting.

How about when there are only a handful of owners in the community? Is an annual meeting really required for these few people? Yes, although the meeting could be conducted less formally if only a few are involved. The meeting could be held in someone's living room, at a local restaurant, or even by the pool. You could turn it into a social event or a meet-and-greet. If sales have been particularly slow, it may be even more important to have an annual meeting to let the few existing owners know that the developer is still in place and that the community will be o.k.

How often must an annual meeting be held? Once per fiscal year. Not to be glib, but this is why it is called an "annual" meeting. That said, it is generally still be acceptable for the association to wait slightly more than one year between meetings for convenience and similar reasons. For example, if the association's 2008 annual meeting was held in December, it is probably fine for the association to wait until January or February 2010 to hold the next annual meeting. It generally works best if the association holds its annual meeting at about the same time each year.

When must the annual meeting be held? That depends on the association's by-laws and perhaps state law. The association's by-laws may name a specific date, such as the second Tuesday of January, or specify a particular time of year, such as the first or last quarter of the year. Sometimes, but not often, state law imposes similar timing requirements. If no particular date or time of year is required, the association can pick any date that is convenient.

What business must be conducted at the meeting? An election to fill one or more director seats is usually conducted, except when the owners do not yet have the right to elect directors. It is also common for state law to require that reports be made at the annual meeting on the financial condition of the association and activities of the association. Think of this as a sort of annual state of the association address. The financial report should include a report on the present financial condition of the association but may also include an annual financial report summarizing expenditures

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for the previous fiscal year and/or a presentation of the next year's budget. It is also customary, but not required, to set aside time in the meeting for an owners forum or Q&A period to allow owners to ask questions of the board, raise concerns, or air grievances.

What if a quorum is not achieved? Do we have to keep rescheduling the annual meeting until a quorum of members shows up? No. The board of directors only has the responsibility to schedule and conduct the annual meeting. If a sufficient number of owners do not show up, it is not the fault of the board, although you may want to consider holding the meeting at a time that is more convenient for owners next year. If a quorum is not obtained, items that require a member vote cannot be conducted, such as elections, but officers can still give their presentations, which do not require a vote.

Seasons Greetings from Hyatt & Stubblefield, P.C. We wish you continued success and prosperity in the new year.

Inside News

- Jo Anne Stubblefield was a presenter for the November 12, 2009 American Law Institute-American Bar Association teleseminar/audio webcast entitled "ILSA: The Sword and Shield of Residential Real Estate Contracts," discussing recent court decisions addressing use of the Interstate Land Sales Full Disclosure Act by buyers seeking to rescind contracts.
- Jan Bozeman was appointed to the Georgia Association for Women Lawyers Foundation Advisory Board.
- David Herrigel was a presenter at the Georgia State Bar's Real Property Law Institute Mixed-Use Developments program in Amelia Island, Florida in May, 2009.
- David Herrigel also was a presenter at the National Business Institute seminar - Mixed-Use Development From A to Z, in Atlanta in August, 2009.

We would be pleased to send **The Client Letter** to friends and business associates who you feel would benefit from receiving it. Just send our office a note with their names and addresses or give us a call at 404-659-6600.

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