

Stopping a Wall St.
Zombie Tax 24

Top Ten Turnaround
Markets 18

PERSONAL REAL ESTATE INVESTOR MAGAZINE

BUILDING WEALTH THROUGH PROPERTY INVESTMENT

Learn from
**The World's
Most Successful
Residential Investor**



Capital Cities
Chicago, IL
Baltimore, MD



David Liniger
Chairman/Cofounder
RE/MAX



MemphisInvest.com
Supplement

September/October 2010
Price \$5.95 US \$6.95 CAN

0 74470 05527 3 1 0 >



MASTER INVESTOR Pete Julian - Triple Net Houses

Private Transfer Fee Covenants & Home Sale Taxes

Wall Street Tries for a New Zombie Tax on Your Home Sale

By Andrew Waite

Today in the United States there are no overt taxes paid on home sale transactions. There are county title recording fees and homeowners' association transfer fees, but no clear taxation of the transaction amount unless a capital gain is made.

In Canada, Australia and New Zealand these fees are common. These add a minimum of 4.5 percent to every homebuyer's costs. They also add to the capital cost of a home and have assured the cost (and affordability index measurement) is between four and seven times the average annual income. (Only the wealthy need apply!) In contrast, the United States enjoys a national capital cost median from New York City to New Braunfels, Texas, of less than three times income.

Now some "back from the dead" Wall Street mortgage bankers have identified home transfer covenants as an untapped source of revenue or "tax" as a private transfer fee that can be collected on future sales.

OBJECTING TO A "ZOMBIE TAX"

The private transfer covenant (or other covenant to protect any mineral, water or other right) is a term added to a sales agreement for real estate. This right, upon acceptance by the parties to the contract, is recorded on the property for 99 years.

Certain covenants in a transfer agreement are traditional. They may also require payment of a fee by the new owner in a homeowners' association or acknowledge some obligation attaching to the land to be recognized by the chain of ownership. These are typical in a master planned commu-

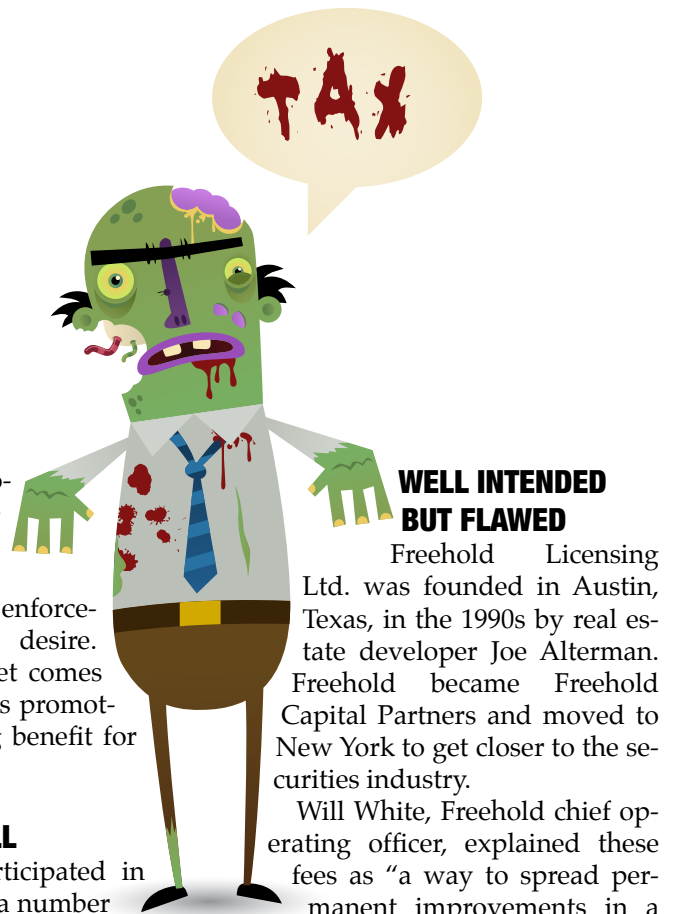
nity, homeowners' association or semi-private water district, etc. A developer of a community can set up any legally enforceable covenant they so desire. This is where Wall Street comes in. A former developer is promoting these as an ongoing benefit for developers.

POISONED (SALES) PILL

Wall Street has participated in the housing business in a number of ways: attempting to privatize Fannie Mae and Freddie Mac; securitizing mortgages to the secondary market and then using fancy financial engineering to slice, dice and leverage; securitizing and selling even more exotic mortgage-backed securities.

These exercises all ended badly. Undaunted, Wall Street is pursuing the taxation of property sales by promoting private transfer covenants in sales agreements.

Freehold Capital Partners has devised a method and is trying to sell developers of residential and commercial properties and homeowners' associations on the idea of charging fees on the second and any additional property transfers for 99 years. Future sales would pay an additional 1 percent in a transfer fee to Freehold, which then would split the fee with the developer. The benefit is being touted to the developer as a future revenue split that can be securitized, sold at a current discount to generate cash to defray current development costs. So far this securitization seed has not borne capital fruit.



WELL INTENDED BUT FLAWED

Freehold Licensing Ltd. was founded in Austin, Texas, in the 1990s by real estate developer Joe Alterman. Freehold became Freehold Capital Partners and moved to New York to get closer to the securities industry.

Will White, Freehold chief operating officer, explained these fees as "a way to spread permanent improvements in a development across all of the current and subsequent owners, and thereby reduce direct expenses for the developer and to all owners over the first 99 years of the development." White explained the values arising from the future transfer as fee cash flow to the developer or homeowners' association. White also volunteered a critical flaw in the process: "Freehold is not a banker or a broker-dealer, so the securitization and capitalization process is the responsibility of a third party."

Until an investment bank recognizes this as a real future value and monetizes it to the present benefit of the developer, the future value is illusory.

KICKING OVER A HORNET'S NEST

It appears Freehold also underestimated the power of the real estate industry. It fights any threat to its income or to the freedom of consumers to buy and transfer real estate. This additional 1 percent transfer fee is seen not only as an undesirable trend, but also as a repeat of the highly unpopular med-



dling in housing by Wall Street investment banks. Freehold is not a Wall Street bank but a small company with an innovative idea and an independent sales agent network out selling to capital-strapped developers.

The Coalition to Stop Wall Street Home Resale Fees is a sophisticated business, employee and consumer rights organization. Its members have helped 16 states outlaw transfer fees. California allows transfer fees but requires very specific disclosure.

The coalition is an eclectic alliance of business and consumer groups, including American Land Title Association; Vets Vote; American Federal, State and Municipal Employees Association;

National Council of La Raza; Transport Workers Union; National Association of Realtors; Center for Responsible Lending; and Property Rights Alliance.

Sixteen states prohibit resale fees, and the coalition is actively lobbying campaigns nationally and in most of the remaining states designed to prohibit fees.

The coalition recently wrote to Tim Geithner, Secretary of the United States Department of the Treasury, and asked for these to be prohibited at a federal level. Fannie Mae and Freddie Mac are rumored to have said they will not back mortgages that contain transfer fee covenants.

Ed DeMarco, Deputy Director and Chief Operating Officer of the Office of Federal Housing Enterprise Oversight, has said that he is “very troubled” by what he is learning about the fees, and that he expects “the enterprises and FHFA (Federal Housing Finance Agency) would have something to say about this issue in the near future.”

MARKET ADOPTION

Freehold claims significant sales representation in most states, even in those that prohibit private home transfer fees. We suspect they are still working the commercial market, homeowners’ associations, or they just do not keep their website up to date.

We identified two developers cited as clients on the Freehold website that have removed these covenants from their agreements, as there was no immediate benefit. The sales objections to disclosing the future transfer tax to current buyers was an added burden with no benefit.

Freehold acknowledges on the website that a transfer fee could reduce the future value of the property by an estimated 1 percent. We believe in addition to price reductions, a property with a transfer fee covenant is less desirable than one that is unencumbered by any price disadvantage, no matter how minor. The mere presence of even a 1 percent transfer fee covenant means that there may be grounds for future increases.

Linda Muscarello, president of National Real Estate Investors Association, said, “This is anti-homeowner, and by definition anti-investor, as it threatens to add costs and make fewer homes desirable for purchase as rental properties. This is bad for everyone but the person collecting the fee.”

BAD PRECEDENT?

This negative reaction is good news for homeowners and the coalition; however, this trend should not be dismissed, as it tests the bigger idea of property transfer taxes that could be instituted by any government intent on increasing revenues through a value added or goods and service tax.

A property transfer is currently an untaxed transaction, but it represents an untapped opportunity for tax revenues that has wide precedent in other countries. Canada charges 7 percent (or at least 4.5 percent in certain exceptions).

Australian states charge a graduated “stamp tax,” named for the approval stamp applied to the deed as it transfers to the new buyer. This adds tens of thousands in revenue to a new, move-up or investment home purchase.

Our federal, state and municipal governments are seeking new ways to raise taxes, and a successful private transfer tax would just add argument for the institution of similar provisions. This fight against private transfer fees or public transfer taxes is far from over.

STOP PRESS:

Zombie Wall Street Transfer Tax To Be Banned?

Federal regulators are moving to ban Fannie Mae, Freddie Mac and the Federal Home Loan Banks from investing in loans with private transfer-fee covenants.

A coalition of real estate industry groups and consumer advocates is campaigning for a federal ban, saying the fees — which are collected each time a home changes hands — rob homeowners of equity, harm their property’s value, and lay the groundwork for legal disputes that threaten smooth property transfers.

The Federal Housing Finance Agency (FHFA) agreed, saying expanded use of private transfer-fee covenants “poses serious risks to the stability and liquidity of the housing finance markets.”

FHFA, in a notice to be published in the Federal Register, wants to ban Fannie Mae and Freddie Mac from purchasing or investing in mortgages encumbered by private transfer-fee covenants or securities backed by private transfer-fee revenue.

The Federal Home Loan Banks would not be allowed to purchase or invest in such mortgages or securities, or hold them as collateral for advances.

RESOURCES

Freehold Capital Partners
www.freeholdcapitalpartners.com
 212-755-0070

National Real Estate Investors Association
www.NationalREIA.com
 888-762-7342

The Coalition to Stop Wall Street Home Resale Fees
www.StopHomeResaleFees.org
 202-724-7944