Summer 2010

Carolina Update

NCLTA's Exclusive Report to its Members

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President's Message

By Carolyn Snipes

Summer is in full swing and the heat isn't letting up. Though the summer is a great season to spend time with family and friends, it has not slowed NCLTA down one bit.

The legislative committee continues to work with David Ferrell to support our agenda in the short legislative session. NCLTA is working on several bills, one of which is Senate Bill 35, Reconveyance Fees Prohibited. This bill addresses the significant problems set out in the article on page 3 of this newsletter. I am happy to report that the Governor signed the bill on July 1, 2010, and it is effective as of the same date. SB 35 was run by the North Carolina Association of Realtors with substantial support from NCLTA and the Real Property Section of the North Carolina Bar Association.

Please note that SB 35 will only ban Reconveyance Fee Instruments filed after the date the bill is enacted. It is still important to understand how the RFIs on record before enactment will affect encumbered land titles.

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Legislative Update

By David P. Ferrell, Esq., NCLTA Lobbyist

Legislators began what they hoped will be a short legislative "short" session on Wednesday May 12, 2010, saying their goal is to produce a state budget before the start of the new fiscal year, July 1. It appears that this will truly be a "short" session, as the legislature convened amid budget talks, news conferences and a protest against federal health care legislation. Senate budget writers met in the months leading up to the start of session, and continued meeting behind closed doors during this first legislative week to try to quickly hammer out the chamber's budget plan.

During the second week of session, the Senate approved a nearly $19 billion spending plan and sent it to the House for consideration. The House produced its own version shortly thereafter and then the two chambers met to reconcile their efforts. As predicted, the House and Senate approved a State budget bill on June 30, prior to the start of the state's fiscal year. Legislative insiders predict the legislature will adjourn the 2010 legislative session on July 9.

Insurance Rate Setting

In a surprise move, the Senate included in their initial draft of the State Budget Bill in May 2010, **Senate Bill 897**, a provision that

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Electronic Recording Moves Forward in North Carolina

Matthew J. Powers, Morehead Title Company, Raleigh, NC

The North Carolina Secretary of State's office approved standards for enabling uniform electronic recording (e-recording), as revised and adopted by the North Carolina Electronic Recording Council (ERC), on April 18, 2007. Together with the work completed on June 20, 2006, by the Advisory Council on Electronic Notarization, North Carolina now has the full framework to implement e-recording and e-notarization across the state. A copy of the North Carolina Uniform Real Property Electronic Recording Act (URPERA), the North Carolina Electronic Notary Standards Statute, and the Secretary of State's Electronic Notary home page can be found by accessing the Secretary of State's website.

As of April 2010, the number of counties that are electronically recording documents nationally has reached 500 according to The Property Records Industry Association. It is important to note that this number represents a 25% increase in the number of counties utilizing e-recording technology from June 2009. In North Carolina, 20 counties have now started to electronically record documents and more than 500 notaries have taken the e-notary classes. Numerous other register of deeds of counties in the state are currently investigating e-recording as a method for the submission of documents as well.

The ERC meets regularly to address new issues that arise as e-recording becomes more widespread across North Carolina. In May 2010, a sub-committee was formed on the e-recordation of plats and maps to review N.C. Gen. Stat. S. 47-30 to determine whether URPERA satisfies the requirements set forth in the statute, to determine issues raised in reviewing both statutory provisions including any recommended amendments which may be necessary, and the identification of possible new ERC standards and or existing ERC standards which require Amendment. Any questions on e-recording or e-notary requirements should be directed to Matthew Powers, Chairman of Best Practices and National Standards, North Carolina ERC at mpowers@moreheadtitle.com.

Convention Calendar

NCLTA 2010 Annual Convention
September 16-18, 2010
Hilton Garden Inn, Kitty Hawk, NC
http://hiltongardeninn.hilton.com/en/gi/hotels/index.jhtml?ctyhocn=ORFKHGI

2010 ALTA Annual Convention
October 13-16, 2010
Manchester Grand Hyatt, San Diego, CA
www.alta.org/meetings/meeting.cfm?meeting=SAM2010Ann

NCLTA 2011 Annual Convention
September 15-17, 2011
The Grove Park Inn Resort & Spa, Asheville, NC
www.groveparkinn.com

NCLTA 2012 Annual Convention
September 13-15, 2012
Wild Dunes Resort, Isle of Palms, SC
www.wilddunes.com

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Reconveyance Fee Instruments in North Carolina

By Carolyn Clark Snipes

A company is now marketing its private transfer fee program[1] in North Carolina. The company, or "Licensor," provides a Reconveyance Fee Instrument ("RFI") to the "Declarant," who is the developer of the property. The developer encumbers its land by recording the RFI in the office of the register of deeds where the property is located.[2] The terms of the RFI usually provide that each time the property is conveyed for a period of 99 years, 1% of the sales price is payable by the seller to a trustee for the benefit of the beneficiaries of the RFI. The beneficiaries are ordinarily the Declarant, holding a one-half interest, and the Licensor sharing the other one-half interest.

Several of these instruments have been filed across North Carolina. This article is based upon the review of three RFIs filed in North Carolina.[3] The first section of the article will explain some of the practical effects the RFIs filed here have on the various parties to a real estate transaction. The second section looks to state statutory and case law to explore to what extent the RFIs are enforceable in North Carolina. Finally, the third section raises issues relating to a real estate closing attorney's ethical obligations as impacted by the RFIs.

RFIs in the Real World

There are numerous ways consumers, builders and others may be impacted by RFIs. Some are best demonstrated by way of this example.

Developer purchases a 50-acre tract of land for development. Developer subdivides the property into 100 lots, builds roads and grants utility easements across the property. Developer executes and records an RFI covenant attempting to encumber the land requiring a payment of a 1% fee each time the property is sold. The RFI does not apply to any sales of the property for a period of two years.

Developer enters into the standard NC Bar form Offer to Purchase Agreement with a Builder for the purchase of a lot for $50,000. The Agreement provides "[t]itle must be delivered at Closing by general warranty deed unless otherwise stated herein, and must be fee simple marketable and insurable title, free of all encumbrances except: ad valorem taxes for the current year (prorated through the date of Closing); utility easements and unviolated restrictive covenants ***that do not materially affect the value of the Property;*** and such other encumbrances as may be assumed or specifically approved by Buyer." *(Emphasis added.)*

Builder seeks loan from Bank for purchase of the lot. Lender orders appraisal of the property, which comes in at the $50,000 price. Lender issues a commitment letter.

Attorney is contacted to conduct closing. Attorney conducts title search and finds the transfer fee covenant on record. Attorney contacts a title insurance company to ask the company to insure that the fees have been paid to date, which it will naturally be reluctant to do, meaning any coverage will take exception to coverage in its policy for the RFI and any and all fees, liens or charges, currently due or payable or that will become due or payable. Attorney notifies Builder, who spent money on obtaining a loan commitment and appraisal, of the fee.

At this point, the Developer signed an Agreement which he cannot consummate without removing the covenant[4], the appraiser gave an opinion on value of the property without knowledge of the covenant, the Lender agreed to loan money on an unreliable appraisal and the Builder expended funds and resources on a property that has an unanticipated encumbrance.

The Scenario Can Become More Complicated

Perhaps the Developer is successful in convincing the Builder to consummate the sale notwithstanding the 1% fee, because any sales in the first two years are exempt and the Developer gave a price reduction of 2%[5], in this case $1,000. Builder is successful

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NCLTA 2010 Annual Convention

The NCLTA 2010 Annual Convention will be held at the Hilton Garden Inn September 16-18 in Kitty Hawk, NC. The hotel is located on the beautiful coast of the Atlantic Ocean giving each guestroom its own unique view while being convenient to shopping, beaches and dining.

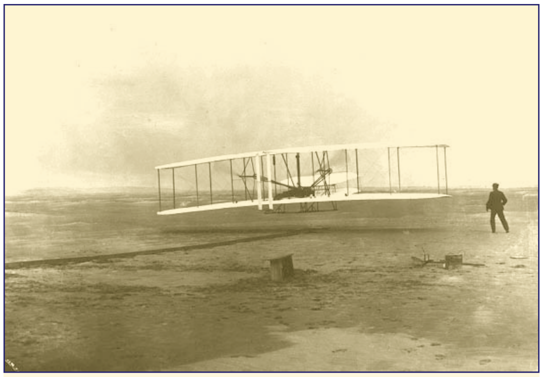
The Hilton offers 180 well appointed guestrooms, while featuring a seasonal outdoor swimming pool and Tiki Bar, fitness center, on-site fishing pier, business center, and off site complimentary tennis at the Kilmarlic Health and Racquet Club. There are several nearby attractions if you desire to travel off property during your stay, including the Wright Brothers Monument, North Carolina Aquarium, Cape Hatteras Lighthouse, and much more.

NCLTA Vice President and Convention Chair Taby Cruden has put together an invaluable list of speakers and an impressive lineup of presentation topics. We hope that you will plan to attend the 2010 NCLTA Annual Convention.

Joseph Ritter of Fidelity National Title will make a presentation on Loan Workout and Modifications and Robert McNeil of Horack, Talley, Pharr & Lowndes will share a Claims Presentation with the group. NCLTA is happy to have ALTA representative Herschel Beard present the ALTA Update. Beard will be traveling to us from Oklahoma. We look forward to hearing what items of interest he will share with the group.

Robert Hobbs of Hornthal, Riley, Ellis & Maland has agreed to present the Case Law Update. Hunter Meacham of First American Title Insurance Company will also make an appearance giving a presentation on Emerging Issues in Commercial Real Estate. We look forward to hearing from Dick Archie as the NCBA Real Property Section Representative as well as David Ferrell of Vandeventer Black LLP giving us a legislative update. An economic update will be presented by Tim Quinlan of Wells Fargo.

While the Continuing Legal Education is why we will be there, we also hope that you will take the time to enjoy some of the local sights. We plan to incorporate much of the local flair with our NCLTA social events; we're embracing the beach lifestyle and casualness throughout the meeting and implementing the casual attitude usually prevalent at coastal destinations. Plan for a dressed down more casual Annual Convention with content worthy of your participation! The Opening Reception will be held outside on the nearby pier. Resort Casual will be the dress code throughout the meeting. We hope you will embrace this more relaxed atmosphere and enjoy networking and mingling with your colleagues at the beach. Looking forward to seeing you all at the beach!



Kitty Hawk is located in the Outer Banks of North Carolina where Orville and Wilbur Wright became first in flight. The town of Kitty Hawk is rich in history and tradition and offers year-round residents and visitors alike a unique and relaxing environment.

When Orville and Wilbur Wright looked for a site for their aviation experiments in 1900, they needed a place with winds regularly over 15 mph with gentle hills for glider launching, a sandy surface for soft landings, and a remote location to avoid public attention. A Kitty Hawk citizen, Mr. Bill Tate, assured the Wrights in a letter that Kitty Hawk would provide the ideal location. In closing, Mr. Tate encouraged Wilbur: "If you decide to try your machine here and come, I will take pleasure in doing all I can for your convenience, success and pleasure, and I assure you, you will find a hospitable people when you come among us." That tradition lives on today.

NCLTA 2010 Annual Convention

Anticipated Agenda

Thursday, September 16, 2010

2:30 - 6:00 pm	Registration Desk Open
3:00 - 5:00 pm	Executive Committee Meeting
6:30 - 8:00 pm	Welcome Reception

Friday, September 17, 2010

8:00 am - 12:30 pm	Registration & Table Top Exhibits
8:15 am - 12:30 pm	GENERAL SESSION
8:15 - 8:30 am	Welcome & Announcements Carolyn Snipes, NCLTA President Taby Cruden, NCLTA Vice President
8:30 - 9:30 am	Loan Workouts and Modifications: *Joe Ritter*
9:30 - 10:15 am	Claims Presentation: *Rob McNeil*
10:15 - 10:30 am	Refreshment Break
10:30 - 11:30 am	Economic Update: *Tim Quinlan*
11:30 am - 12:30 pm	Case Law Update: *Robert Hobbs*
1:30 - 6:30 pm	Golf Tournament
7:00 - 8:00 pm	Cocktail Reception
8:00 - 9:30 pm	Annual Banquet
9:30 - 11:00 pm	President's Reception & Social

Saturday, September 18, 2010

7:30 - 8:15 am	Attorney Section Breakfast
8:00 am - 12:00 pm	Registration & Table Top Exhibits
8:15 am - 12:15 pm	GENERAL SESSION & Annual Meeting
8:15 - 8:30 am	Announcements: Carolyn Clark Snipes, NCLTA President
8:30 - 9:30 am	Emerging Issues in Commercial Real Estate: *Hunter Meacham*
9:30 - 9:45 am	Refreshment Break
9:45 - 11:00 am	Legislative Update & Real Property Section Highlights: *David P. Ferrell,* Vandeventer Black, LLC, Raleigh, NC *Dick Archie,* White & Allen P.A., Kinston, NC
11:00 - 11:30 am	ALTA Update: Herschel Beard
11:30 am - 12:15 pm	Annual Business Meeting

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in obtaining financing by reducing the loan amount and paying more cash up front.

Builder goes on to complete the construction of a house within nine months, but due to the lending environment and excessive real estate inventory, Builder is not able to sell the property within the two-year exemption period. Finally, after carrying the property for one year after the expiration of the exemption period, Builder has an offer for the property of $250,000. Builder discloses the 1% fee upfront to avoid any problems with the purchase agreement. Homeowner is not happy with the fee but likes the property and seeks a similar 2% concession on the purchase price. Builder reduces price by 2% ($5,000) and must also pay 1% ($2,475) transfer fee. Builder bought the property for $1,000 less because of the covenant but had to sell for $7,475, less than he could have without the fee.

Fast-forward five years to the next sale of the property. Homeowner is now moving and seeks to sell the house. Assuming a modest appreciation of 3% per year, and based on the purchase price of $245,000, the house is now worth $284,022. Homeowner is now faced with the same scenario as the Builder. To be able to compete with other sellers whose property is not encumbered by a transfer fee covenant, Homeowner reduces the sales price by 2% ($5,680) and pays another 1% ($2,840) to the Developer, Licensor and other RFI beneficiaries.

The next purchaser, "Homeowner 2" is a young couple buying their lifetime home. They obtain a price concession of 2% paying approximately $278,341 for their new home. They live in the home for 40 years, maintaining it well and paying off their mortgage. Assuming a 2% annual appreciation over 40 years, the property is then valued at $614,587[6]. When they decide sell to downsize for their retirement years Homeowner 2, after a 2% price reduction of $12,291, will pay $6,022 to the Developer and Licensor.

The Builder and Homeowners lost an aggregate value of the property totaling $22,971. Meanwhile, the RFI accumulated $11,337 in fees from the Builder and the Homeowners with no corresponding benefit to the Lot, with 53 years remaining life in the covenant. The fees will continue to accumulate, and loss to the property owners will be incurred, over the remaining term of the RFI. The Developer and Licensor will continue to receive a portion of the increasing value of a home they did not build, maintain, or renovate at the expense of each subsequent owner of that property.

Lenders May Also Face Significant Issues

The transfer fee instruments vary as to if and when lenders who acquire or sell property must pay the transfer fee. In one instrument, the lender is exempted from payment of the fee for any transaction that relates to the payment of its debt. Presumably this means the lender need not pay when it is the highest bidder at a foreclosure sale, when it sells the property after such a foreclosure or when it accepts a deed in lieu of foreclosure.

In another instrument, the lender is exempted only for a conveyance "made in connection with a judicial or non-judicial foreclosure," meaning the trustee's deed. The fee would be due from the lender upon sale to a third party. Furthermore, regardless of the extent of the exemptions available, it will face the same challenge as the Builder and Homeowner had in finding a purchaser willing to buy the property with the covenant in place. The lender will likely be forced into price concessions, thus making it more difficult, if not impossible, for the lender to recoup its losses on the defaulted loan.

In both instruments, the exemption from payment of the transfer fee is limited to *institutional* lenders, defined as "any bank, government sponsored entity, saving and loan association or other lender that is engaged in the business of owning, servicing or providing mortgage financing on real property and is licensed to engage in such business if required by applicable law." A seller who carries a note

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on the property secured by a deed of trust is not exempt from paying the fee in a foreclosure or deed in lieu of foreclosure situation.

Going back to the example above, let's assume that Homeowner 2 is having trouble selling the home because, for whatever reason, financing is simply not available to those who would be interested in buying. Homeowner 2 decides to owner-finance a sale. At closing, Homeowner 2 pays the 1% fee after making the 2% price concession due to the covenant. After a year of timely payments, the Buyer falls on hard times and can no longer pay. Homeowner 2 must either foreclose or accept a deed in lieu of foreclosure, both of which are considered "conveyances" under the RFI.

Homeowner 2 is ***not*** a lender entitled to any exemption. Therefore, the Homeowner 2, having already paid the transfer fee at the original sale, must pay 1% again from the proceeds of the trustee's sale. Adding further pain, if Homeowner 2 is the high or only bidder, Homeowner 2 will pay the 1% fee a ***third*** time when it resells the property. The impact of the RFI on Homeowner 2 is that they obtained a price reduction at the time of purchase of $5,681; and paid out $18,437 to the Developer and Licensor on top of absorbing a $12,291 price reduction at sale.

Benefits of RFIs?

The Licensor states that the future owners of the property benefit from the covenant because "property encumbered by a 1% fee should sell for less than property without a fee. A buyer paying less at the time of purchase in return for paying 1% at the time of a future sale will typically have lower carrying costs, lower acquisition costs, etc. A buyer who buys for less can sell for less, and thus has a competitive advantage."

The Licensor characterizes the depression of the value of an owner's home as an advantage. Unfortunately, this seemingly overlooks the fact that in addition to the lower sales price, the homeowner will also have to pay the 1% fee, further reducing the net proceeds of equity earned by the owner on sale. Perhaps sellers that ***need*** to sell a property would desire to have the ability to sell for less, but for sellers who merely ***want*** to sell, a lower price realized from a sale is likely less appealing.

The Licensor goes on to state that the covenant will not interfere with the ability to sell property. "The Reconveyance Fee Instrument is just one of numerous factors that influence a purchase decision. Experience says the modest 1% fee will not generally be deemed substantive by most buyers, particularly since they can adjust the purchase price and do not pay the fee until the time of their future sale (and can plan accordingly)." Again, the argument appears to be that the fee will not interfere with a sale since the buyer can just seek a price reduction to compensate for it. Though the 1% fee is characterized as "modest," it is substantial enough that the Licensor acknowledges, and touts as a benefit, the fact that it will reduce the price a buyer is likely willing to pay. Furthermore, while the fee is payable at a future sale, it is important to remember that the fee will be calculated on the presumably higher sales price, which should reflect maintenance, improvements, renovations and appreciation of the property during any given period of ownership.

Legal Issues

In addition to the practical issues surrounding the RFI program, questions remain as to its enforceability in North Carolina. Is the RFI a valid real property interest? Is the RFI an unreasonable restraint on alienation? Is the fee a private tax? Does the covenant run with the land such that it can bind successors of the Developer for 99 years? Can the RFI constitute a valid lien on the property without statutory authority? If so, can the lien be foreclosed by the power of sale? What is the impact of the RFI on the marketability of title? What is the impact of the Marketable Title Act on the RFI? This section will address just a few of these questions.

Is the RFI an unreasonable restraint on alienation?

The RFI purports to create a non-possessory interest in land. The Licensor, in its denied and (later listed as "abandoned") patent application, characterizes the RFI covenant as

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a "springing interest" and an "interest in real estate." Setting aside the question of whether the Licensor can create a valid interest in land not recognized by the common law, we look to the public policy of this State to determine if the private transfer fee covenant is an impermissible restraint on alienation. It is the public policy of North Carolina, as set forth in NCGS 47B-1, that

1) Land is a basic resource of the people of the State of North Carolina and should be made freely alienable and marketable so far as is practicable.
2) Nonpossessory interests in real property, obsolete restrictions and technical defects in titles which have been placed on the real property records at remote times in the past often constitute unreasonable restraints on the alienation and marketability of real property.
3) Such interests and defects are prolific producers of litigation to clear and quiet titles which cause delays in real property transactions and fetter the marketability of real property.

"The policy against restraints on alienation is said to be based upon the belief that restraints remove property from commerce, concentrate wealth, prejudice creditors, and discourage property improvements." Crockett v. First Federal Savings & Loan Ass'n of Charlotte, 289 N.C. 620, 627-28, 224 S.E.2d 580, 585-86 (1976) quoting A. Casner & W. Leach, Cases and Text on Property 1008 (1969 Ed.). Restatement of Property § 410, Comment a, at 2429 (1944) reasons that restraints on alienation may be justified "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." Crocket at 628, 224 S.E. 2d at 586.

Looking to the example above, the policy concerns seem applicable to the covenant. The purported estate is a non-possessory one. The 99-year term of the RFI will eventually constitute a remote interest. In fact, the RFI may not even be discovered in the chain of title because the title search period on the typical residential real estate closing is 30 years The RFI restricts the right to freely alienate property by requiring a fee be paid to private individuals and companies for the privilege to do so. The fee reduces an owner's equity in the property potentially prejudicing creditors like contractors who actually provide value and benefits to the property but are unpaid. The RFI also may also discourage property improvements as the incentive to do so is lessened when a third party stands to gain from the labor of the landowner without making any contribution to the improvements.

RFIs will also impact an owner's ability to sell the land to a buyer who intends to obtain some types of financing. In response to inquiries by the National Association of Realtors, the Department of Housing and Urban Development ("HUD") has said that "[a private transfer] fee unnecessarily increases the cost of homeownership...." Furthermore, HUD's General Counsel "confirmed that the private transfer fees would clearly violate HUD's regulations at 24 CFR 203.41, which prohibit 'legal restrictions on conveyance,' defined to include limits on the amount of sales proceeds retainable by the seller." HUD's reluctance to insure loans on land subject to an RFI may result in significant harm to owners attempting to sell their properties.

There are numerous reasons why RFIs constitute an unreasonable restraint on alienation and how they affect the marketability of title. Any benefits that could possibly be realized from the private transfer fee are outweighed by interference the RFI is likely to cause in an owner's ability to convey land.

Does the covenant run with the land such that it can bind successors of the Developer for 99 years?

RFIs are likely an unenforceable personal covenant not binding on successors in interest to the property in North Carolina. In order for a covenant to run with the land it must touch and concern the land. MidSouth Golf v.

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Fairfield Harbourside Condominium Assn., 187 N.C. App 22, 31, 652 S.E.2d 378, 384 (2007), see also Raintree Corp. v. Rowe, 38 N.C. App, 664, 248 S.E.2d 904 (1978). It must both benefit and burden the land. Id. Otherwise, it is a personal covenant not binding on successors. Id. at 30, 652 at 384. The benefit to the land must "respect the thing granted or demised, and... the act covenanted to be done or omitted, must concern the lands or estates conveyed." Id. at 32, 652 S.E.2d at 385. "[T]he object of the covenant must be annexed to, inherent in, or connected with, land or other real property, or related to the land granted or demised." Id.

In MidSouth, the declaration of restrictive covenants provided that the homeowners be assessed a *license* fee for maintenance of recreational amenities owned by the declarant, regardless of whether or not they used the amenities. MidSouth, 187 N.C. App at 33, 652 S.E.2d at 386. The homeowners had no easement rights in the amenities. Id. at 35, 652 S.E.2d at 387.

The court in MidSouth relied heavily upon the precedent set by the court in Raintree. In Raintree, a developer created a covenant requiring all lot owners to be members of a country club and pay dues. The court found that the covenant did not run with the land.

> This covenant creates an affirmative duty, a charge or obligation to pay money, *i.e.,* country club dues, for the services and use of the country club facilities which are not upon, connected with, or attached to the defendants' land in any way. The [lot owners] are required to pay, whether they use the facilities or not. The payment of a collateral sum of money does not concern the land. Nesbit v. Nesbit, 1 N.C. 490, 495, 1 Cam. & Nor. 318, Cam. & Nor. 318 (1801) Courts have generally held that covenants to pay money do not touch and concern the land. Neponsit Property Owners' Ass'n v. Emigrant Industrial Sav. Bank, 278 N.Y. 248, 15 N.E.2d 793 (N.Y. 1938))... We find that the performance by the defendants of this covenant is not connected with the use of their land and does not touch or concern their land to a substantial degree.

Raintree, at 670, 248 S.E.2d at 908-09. Like in Raintree, the court in MidSouth concluded that "the recreational amenities are not appurtenant to [the land] and therefore the covenant to pay amenity fees does not touch and concern [the land]." MidSouth. at 36, 652 S.E.2d at 388.

RFIs also appear to be a personal covenants that do not run with the land. The fee imposed by the RFI is a burden on the property without a corresponding benefit to the land. Like in MidSouth and Raintree, fees due under the covenant are not connected with the land. Even more striking is that the RFI provides for payment of a fee that is for the profit of the Developer and Licensor without any ongoing benefit to the land.

The RFI seemingly attempts to meet the "touch and concern" test by creating a "benefit" in the form a non-profit donation. The RFIs recorded in North Carolina allocate 5% of the 1% fee to a non-profit that benefits organizations "engaged in non-political, non-religious activities for the direct or indirect benefit of the community within which the Property is located, it being the intention of [the RFI], the Beneficiaries and each owner that a portion of the Reconveyance Fee arising from the Property be reinvested in the community for the direct or indirect betterment of the Property and the land within the community... The Trustee's discretion and determination as to the interpretation and application of this subparagraph ... shall be conclusive..." The RFI further states that the "Parties to the Declaration, including each Owner (by acceptance of a Conveyance Instrument) acknowledge, agree and stipulate that (i) non-profit organizations build better communities and enhance property values ... and (iii) the foregoing touches and concerns the land." There is no requirement that the benefit actually run in favor of the specific tract of land conveyed, the subdivision as a whole, or even the city in which the property is located.

Based upon the reasoning of MidSouth and Raintree, RFIs do not touch and concern the land. The covenant is merely a personal one that is unenforceable against those not party to the RFI. Therefore, it does not run with the land and should not be binding on buyers.

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Can the RFI constitute a valid lien on the property that can be foreclosed by the power of sale?

In two of the RFIs examined for this article, the RFI purports to be a lien on the property from the date of recording, even for fees that may become due in the future. They also provide that, if not paid when due, the fee becomes a personal obligation of the owner of the property. Each of the RFIs purports to allow for non-judicial foreclosure of the lien for unpaid transfer fees. However, unlike liens permitted under the Condominium Act and the Planned Community Act, there is no statutory authority for the RFI to constitute a lien on the property in North Carolina. Furthermore, power of sale foreclosures are limited to "sale[s] of real property or a sale of any leasehold interest created by a lease of real property pursuant to (i) an express power of sale contained in a mortgage, deed of trust, leasehold mortgage, or leasehold deed of trust or (ii) a "power of sale", under this Article, authorized by other statutory provisions."7 N.C.G.S. 45-21.1(a)(2).

How have other states treated RFIs?

Eighteen state legislatures have addressed for-profit, private transfer fees. Arizona, Florida, Iowa, Kansas, Maryland, Minnesota, Missouri, Oregon and Utah have enacted laws banning the fees. Alabama, Hawaii, Illinois, Louisiana, Ohio, Rhode Island and South Carolina have bills pending to do the same. The bills in Hawaii and Illinois have passed in both chambers of the legislature and are awaiting the governors' signatures. Texas has a statute that appears to ban the private transfer fees, however; the Licensor offers a differing interpretation. Finally, California enacted a law that requires substantial disclosures for enforceability of for-profit, private transfer fees.

Ethical Dilemmas for the Closing Attorney

The existence of an RFI may also create an ethical issue for attorneys conducting closings on behalf of their developer clients when they are also closing the out-sales. An attorney may only represent the developer and buyer in a closing if the "[a]ttorney reasonably believes that the common representation will not be adverse to the interests of either client, there is full disclosure of Attorney's prior representation of Seller, and Buyer consents to the common representation." North Carolina State Bar 97 Formal Ethics Opinion 8, citing RPC 210 and Rule 2.2 of the Revised Rules of Professional Conduct. The ethics opinion goes on to state:

> [i]f the interests of the buyer and seller of residential property are generally aligned and the lawyer determines that he or she can manage the potential conflict of interest between the parties, the lawyer may represent both the buyer and the seller in closing a residential real estate transaction with the consent of the parties.
>
> Before concluding that common representation is permitted, the lawyer must consider "whether there is any obstacle to the loyal representation of both parties." RPC 210. The lawyer may proceed with the common representation only if the lawyer reasonably believes that his or her loyalty to the seller will not interfere with the lawyer's responsibilities to the buyer. Rule 2.2(a)(3).

North Carolina State Bar 97 Formal Ethics Opinion 8.

This analysis applies equally to common representation under RPC 210, even where the seller is ***not*** the developer. If the RFI was not disclosed to the buyer in the purchase contract, the attorney will be in a position of having to advise the buyer of the covenant and the buyer's rights under the agreement, which may be contrary to the interest of the seller. When faced with the question by a buyer of whether he should purchase the lot with the RFI (and associated fee) or a different lot down the street without an RFI, could the attorney answer while remaining loyal to both parties?

Common representation of the buyer and lender is equally problematic. If the existence of the RFI is not known to the lender, the attorney then potentially has a serious conflict. The attorney will have a duty to advise the lender about the RFI and its ramifications, which may cause the lender to rescind its loan commitment. The required disclosure negatively impacts the buyer who could then

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Reconveyance Fee Instruments in North Carolina

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be without funding after expending money on inspections, surveys, etc. Depending upon the timing of the discovery of the RFI, the buyer may also forfeit any earnest money deposit. The ability of an attorney to represent the buyer and lender in a transaction is limited to situations where

> the interests of the buyer and lender are generally aligned and the lawyer determines that the potential conflict of interest can be managed. Rule 5.1(a). As stated above, before concluding that the common representation will not be adverse to the interests of any one client, the lawyer must determine three things: he or she will be able to act impartially; there is little likelihood that an actual conflict will arise out of the common representation; and, should a conflict arise, the potential prejudice to the parties will be minimal.

North Carolina State Bar RPC 210. An RFI makes the delicate balance of simultaneous representation of sellers, buyers and lenders even more fragile.

Conclusion

With several RFIs recorded in North Carolina, it is important that the covenants be closely examined for the impact they have on builders, sellers, buyers, lenders and their representatives. Just as urgent is the need to evaluate whether RFIs are permissible under North Carolina law so that the orderly and efficient transfer of property will not be impaired.

Footnotes:

1 The fee is sometimes called a "reconveyance fee" or a "capital recovery fee."

2 This method of recording is most common, though it is also possible that the covenants will appear in the development's declaration of covenants and restrictions or simply in each deed from the developer. It is important for attorneys to read though the entire declaration of covenants on a subdivision to determine whether such a covenant purports to encumber the property.

3 This article is based upon a review of three RFIs filed in North Carolina: (a) Book 4756, page 623, Buncombe County Registry, (b) Book 3635, Page 93, Moore County Registry, and (c) Book 25226, Page 742, Mecklenburg County Registry.

4 The RFIs usually provide that property may be release from the covenant by the Declarant only prior to the earlier of the sale, conveyance, transfer or assignment of the Declarant's interest in the released property, the Declarant's beneficial interest in the RFI, or a controlling interest in the Declarant. The right to terminate is personal to the Declarant and may not be conveyed, assigned or otherwise exercised by another party, including heirs.

5 The 2% reduction is based upon an example in Licensor's brochure illustrating a price reduction on a property with a 1% reconveyance fee.

6 At 3% annual appreciation the value would be $907,958.

7 N.C.G.S. 47C-3-116 and N.C.G.S. 47F-3-116 allows imposition of liens for failure to pay assessments to a homeowner's or unit owner's association, both of which must be non-profit associations and must use the funds collected for the common elements of the development.

President's Message

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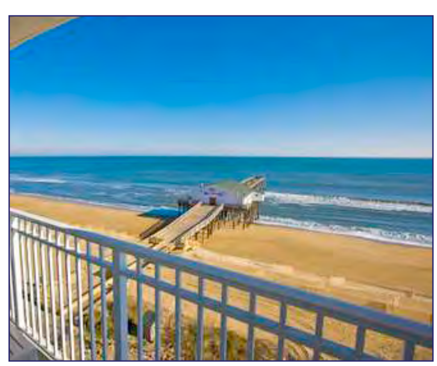
In addition to NCLTA's legislative efforts, the loss prevention committee is continuing its conversation with the State Bar and the Real Property Section Council about trust account auditing. A Consent to Audit form is finalized and available on the NCLTA website for distribution to approved attorneys. Click here for a copy along with a cover letter explaining the form. Also on the horizon is an educational program on trust account management and audit processes.

Even in slower economic times, we remain as busy as ever. While there is more summer to come, I look forward to winding it down with you at our Annual Convention in Kitty Hawk on September 16-18, 2010.

In the meantime, enjoy the long summer days and stay cool!



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would shift the authority to set insurance rates, ***including title insurance rates,*** from the Commissioner of Insurance and the North Carolina Rate Bureau to a newly formed seven-member "Insurance Rate Commission." This new Commission would be modeled after the system for setting public utility rates by the NC Utilities Commission. The provision did not remain in the Senate Budget Bill for long, for the full Senate Appropriations Committee voted to remove the provision at their Tuesday May 18 meeting. It appears that the provision was added to the bill at the request of legislators from some coastal counties who are unhappy with soaring homeowner insurance rates in coastal counties.

This insurance rate setting provision was ***not*** included in the version of the budget bill approved by the Senate and was ***not*** in the budget bill adopted June 30.

Reconveyance Fees Prohibited

NCLTA's top legislative priority for 2010 was the passage of **Senate Bill 35, Reconveyance Fees Prohibited**. NCLTA worked with the North Carolina Association of Realtors and the Real Property Section of the NCBA for the passage of this bill. As President Carolyn Snipes discusses in her President's Message and in her article on Reconveyance Fees in this newsletter, the bill would ban reconveyance fees in North Carolina.

With the cooperation of the Senate leadership, we identified a Senate bill that had already passed the Senate and was in the House, but was not going to be enacted into law this session. Senate Bill 35, originally titled "Early Organizational Session", was renamed "Reconveyance Fees Prohibited", and contains the reconveyance fee ban. The text of the bill was modeled after the American Land Title Association's model bill, with certain modifications to take into account North Carolina law.

Senate Bill 35 was unanimously approved by the House Judiciary III Committee and the full House in early June and was sent to the Senate to consider the House changes. Senator David Hoyle (D-Gaston) referred the bill to the Senate Rules Committee, where he is the Chairman. Freehold Capital Partners, the New York company that markets reconveyance fee covenants to developers, hired a lobbyist and began working against the bill. The Senate Rules Committee held hearings on the bill on two separate days. Carolyn Snipes spoke to the committee on behalf of NCLTA in favor of the bill. After much consideration, the committee approved the bill. The full Senate unanimously approved the bill on June 23 and it was signed into law by Governor Perdue on July 1.

Here's a link to final version of Senate Bill 35: www.ncga.state.nc.us/Sessions/2009/Bills/Senate/PDF/S35v7.pdf

New Bills of Interest

House Bill 1659, Eminent Domain, would amend the constitution of North Carolina to prohibit the taking of private property by eminent domain except for a public use, which would not include taking property in order to convey an interest in the property for economic development. The bill was Introduced by Representatives Stam and Lewis. The House Judiciary II Committee approved the bill on June 24. The bill was approved by the full House on June 29 and sent to the Senate for consideration.

Senate Bill 1216, Extend Emergency Foreclosure Program, would extend the expiration date for the Emergency Program to reduce Home Foreclosures to November 1, 2010. The bill would require that pre-foreclosure notices filed with the Administrative Office of the Courts (AOC) include the due date of the last scheduled payment made by the borrower. The bill would establish the State Home Foreclosure Prevention Trust Fund under management of the Office of the Commissioner of Banks, and would require the Commissioner to collect a $75 fee from the mortgage servicer at the time a pre-foreclosure notice is filed. The bill would allow for the imposition of one fee per 12-month period for a home loan. The changes would be effective November 1, 2010, and expire on May 31, 2013. The bill

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was Introduced by Senator Blue. The technical changes were made to the bill as it moved through the House and Senate, and was approved by the House and Senate on July 7.

Senate Bill 1862, Orange/Alamance Boundary. The bill states that there is uncertainty of the boundary line between Alamance and Orange counties, which affects taxation, school attendance, zoning maps, and elections. The bill provides details for the transition process of establishing a boundary baseline based on a mutually agreed upon resurvey of the Alamance County and Orange County boundary line by the North Carolina Geodetic Survey (NCGS). The bill would require all instruments filed or registered that involve residents and property in the areas affected by the resurvey to be recorded in the county to which the property has been annexed on or after July 1, 2011. The bill would require Alamance County and Orange County to submit a completed survey that includes the NCGS line and all mutually agreed upon modifications to the General Assembly no later than May 15, 2011. The bill directs that owners and future owners of property affected by this act be put on notice as to its terms and conditions via a written notice filed in the office of the register of deeds office of the county in which the property has been annexed. The bill was Introduced by Senator Kinnard. The bill was approved by the Senate and House and was ratified on July 7.

Bill Status

Senate Bill 1015, Homeowner and Homebuyer Protection Act. A new version of Senate Bill 1015, introduced in 2009 by Senator Josh Stein (D-Wake), was considered by the legislature during this short session. In the House, the committee discussing the bill heard from attorneys with Legal Aid and the NC Justice Center about consumers who have been mislead by unscrupulous people in either installment land contract, lease option to purchase, and foreclosure rescue situations. The overriding theme is that these consumers are not sophisticated and do not have an attorney perform a title search on the property. So they often enter agreements and make payments to those who do not have title to the property, or they are not aware of significant liens on the property.

The bill would prohibit ***foreclosure rescue scams*** where there is an expectation of financial gain. The bill would make a violation of this section an unfair and deceptive trade practice, and allow a party harmed in a foreclose scam to void a transaction. At NCLTA's request, the bill was amended to provide that a conveyance to a bona fide purchaser for value could not be voided.

The bill would create a new statute to regulate ***option to purchase contracts executed with lease agreements***. The bill would require such contracts to be in writing, contain certain information, establish a three-day cancellation period, disclosure of mortgages and liens on the property, and require the contracts to be recorded on the land records. An option contract that does not comply with this law is voidable at the option of the option purchaser. At NCLTA's request, the bill sponsor agreed to amend the bill to provide a mechanism to remove these contracts from the land record after satisfaction or default.

The bill would create a new statute to regulate ***installment land contracts or contracts for deed***. The bill would define such arrangements as those that would require five or more payments in addition to the down payment where the seller retains title to the property as security for the purchaser's obligation under the agreement. The bill would require such contracts to be in writing, contain certain information, establish a three-day cancellation period, disclosure of mortgages and liens on the property, and require the contracts to be recorded on the land records. The bill would require the seller to provide the buyer periodic statements of account at lease once every 12 months. At NCLTA's request, the bill sponsor agreed to amend the bill to provide a mechanism to remove these contracts from the land record after satisfaction or default.

Senate Bill 1015 was approved by the House on July 6, and changes made in the House were approved by the Senate on July 7.

For more information about legislation described in this article, feel free to contact me at dferrell@vanblk.com or (919) 754-1171. Information is also available on the General Assembly's website: www.ncga.state.nc.us.

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