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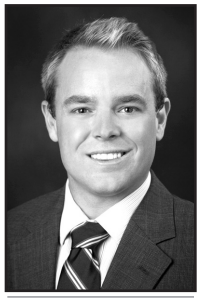
# Legislation prohibits covenants for transfer fees upon conveyance

Real property law favors free transferability and marketability and disfavors unreasonable restraints on alienation that do not "touch and concern" the land. Senate Bill 11-234 (the "bill"), recently signed into law by Gov. Hickenlooper, seeks to reinforce this principle by prohibiting covenants that require the payment of transfer fees upon the conveyance of residential real property in Colorado to the extent such fees do not touch and concern the land. The rising popularity of transfer fee covenants in Colorado and other states threatened the notion of free transferability and marketability such that the General Assembly felt compelled to act, notwithstanding the significant protections afforded by the common law. This article provides a brief summary of the bill, highlighting enforceability concerns and describing issues the beneficiary of a payment arising out of a transfer fee covenant (a "payee") should know to continue receiving payments.

**Jim Johnson**
Managing director, Otten Johnson Robinson Neff + Ragonetti PC, Denver



**Ty McKinstry**
Associate, Otten Johnson Robinson Neff + Ragonetti PC, Denver

As an initial matter, it is important to understand the bill's definitions, as they identify which fees and covenants fall within its scope. A "transfer fee" is described as a fee required to be paid either partially or fully upon conveyance of residential real property. "Conveyance" is defined to include sales, gifts, assignments, inheritance and any other transfer of an interest in residential real property. "Residential real property" is defined as real property containing residential improvements and real property upon which construction of residential improvements has commenced. A "transfer fee covenant" means a provision in a recorded or unrecorded document that requires payment of a transfer fee. The bill is intended to make transfer fee covenants unenforceable, with the exception of certain "excluded provisions."

The bill permits certain fees that would otherwise be categorized as transfer fees by defining a set of excluded provisions. These excluded provisions generally include those that touch and concern the land, including payments to lenders, brokers, lessors, governmental and quasi-governmental entities, homeowners' associations and certain nonprofit entities. The issue, of course, is whether the General Assembly has captured within excluded provisions all such fees that touch and concern the land (for example, some deferred payments in purchase and sale contracts may appear to be excluded provisions but may actually be unenforceable), and whether the bill might have been more appropriately structured to permit transfer fee covenants, except for those categories of fees that do not touch and concern the land. Alternatively, the General Assembly could have done nothing at all and simply relied on the common law.

In any event, having set forth the relevant terms, the bill separates transfer fee covenants into two groups, depending on the timing of recordation. The first group, which are unenforceable, are comprised of those transfer fee covenants executed but not recorded prior to May 23, 2011. There are the penalties associated for recording such covenants after May 23, 2011. Any person who records, or causes to be recorded, such transfer fee covenants after May 23, 2011, is liable for any actual damages resulting from the imposition of the covenant and all attorneys fees and costs incurred by a party to the conveyance, including those associated with the recovery of already-paid transfer fees and actions to quiet title to the burdened property.

The second group of transfer fee covenants, those recorded prior to May 23, 2011, may remain enforceable, but only to the extent the payee complies with certain requirements. The bill imposes two requirements on payees of transfer fee covenants recorded prior to May 23, 2011. First, before Oct. 1, 2011, payees must record a "notice of transfer fee" against the real property burdened by the transfer fee covenant in the county where the real property is located. Such notice must include specific information regarding the amount of the transfer fee, the payee, a description of the burdened real property, the planned use of the transfer fee proceeds and the method by which a lien arising under the transfer fee covenant may be released. After Oct. 1, 2011, all transfer fee covenants that are not in compliance with this notice requirement will be unenforceable. There are legitimate questions regarding whether a payee should record a precautionary notice where the covenant contains an excluded provision and how a payee can comply where the amount of the fee cannot be estimated as of Oct. 1, 2011.

Second, any owner of residential real property burdened by a transfer fee covenant may request in writing a statement from the payee specifying the amount of the transfer fee payable on the burdened property. The payee has 30 days to respond to such request with a written statement setting forth the amount of the transfer fee. If the payee fails to respond to the request within such 30-day period, then upon recording an affidavit indicating the lack of response, the property owner may convey the burdened residential real property without the need to pay the transfer fee.

In summary, transfer fee covenants that were not recorded prior to May 23, 2011, are unenforceable. Payees of these covenants should refrain from recording the same to avoid potential liability. Payees of transfer fee covenants that were recorded prior to May 23, 2011, should record a Notice of Transfer Fee prior to Oct. 1, 2011, and timely respond to inquiries from burdened property owners. In either event, payees under a transfer fee covenant should scrutinize its provisions with reference to the bill's language to determine if the covenant contains excluded provisions.▲