How “Spec” Condo and Tract Home Buyers Helped Sink Our Housing and Finance Markets: Should the Alienability of Their Interests Be Restrained by Law? (Forthcoming in 36 J. LEGIS. (2009))

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How “Spec” Condo and Tract Home Buyers Helped Sink Our Housing and Finance Markets: Should The Alienability of Their Interests Be Restrained by Law?

By George Lefcoe*

This paper begins by recounting the extent to which speculating buyers contributed more than proportionately to housing price volatility and the rate of mortgage foreclosure. Home ‘flippers’ never expect to take up occupancy in the houses they buy, hoping to profit from a quick resale. Speculating home buyers represented about a quarter of the market in many cities and accelerated falling house prices and rising foreclosure rates by defaulting as soon as the housing bubble started to shrink, and far more quickly than would owner occupants. Had spec buyers been kept out of the market, housing prices would have been less volatile and foreclosure rates lower.

The second section turns to the way spec buyers deceived mortgage lenders by committing occupancy fraud, claiming falsely that they were buying as owner occupants so they could benefit from more favorable mortgage rates and terms. Though spec buyers were violating federal and state laws, and the FBI has pursued some egregious perpetrators of occupancy fraud, the best way of deterring borrowers from committing occupancy fraud is by lenders screening them out through improved underwriting. Telltale signs in loan applications and borrower background checks make occupancy fraud detectable, though ideally with the aid of specially designed software and considerable determined effort.

The third section starts by describing the mischief spec buyers caused home builders and condo developers by signaling phantom housing demand, and degrading ‘for sale’ housing tracts and condo developments by leaving newly bought homes vacant or filling them with short term rentals. Next, we describe the means used by homebuilders to restrain home flippers, and why these restraints tended to appear only in purchase and sale contracts and not in deeds, confining enforcement to contract actions against flip buyers but not upsetting sales to the flip buyers’ buyers. The doctrine barring all but promissory restraints on alienation figures prominently here, along with practical marketing considerations.

The fourth section explores the rationale for a government imposed ban on home flipping. This would be a publicly imposed constraint on alienability. Here, we examine a particular proposal that a law professor advanced a few years ago for a local ordinance that would bar new home or condo resales by spec buyers for a period of years. After detailing the drafting issues that would need to be resolved in such an ordinance, the paper concludes that an inalienability ordinance would no longer be sustainable because spec buyers are now welcome and widely perceived as much needed rescuers in resuscitating deflated housing markets by bidding up the prices of foreclosed properties.

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I. Spec Buyers Contributed to House Price Volatility

When house and condo prices were soaring in many regions of the US from 2004 to 2006, speculating buyers climbed on board for the all-too-fleeting joy ride. They hoped to profit from reselling swiftly without ever moving in, and lied to lenders and developers, claiming their acquisitions were for their own use and occupancy. Spec buyers began to awaken from their dreams of quick riches and started defaulting on their mortgages in droves the moment house prices showed signs of flattening out; they wouldn’t be able to recoup their invested equity plus their share of the closing costs, typically 5 to 10%. With spec buyers forming about a quarter of the market, University of Texas economics Professor Stan Leibowitz explains: “These numbers are large enough that if only a minority of speculators defaulted when housing prices stopped increasing, it could explain all or most of the increases in foreclosures started.”

To see how this played out in one market, consider Las Vegas where home and condo prices rose sharply 2004-2005, peaked in June, 2006, and began a slow descent, dropping 40%-50% by 2009. “Flip” buyers tended to purchase older and smaller homes than owner-occupants. Their

2 Andrea Pescatori & Bethany Tinlin, Home Prices, ECONOMIC TRENDS, April 12, 2007, available at http://www.clevelandfed.org/research/trends/2007/0407/02monpol.cfm. “Although growth rates in structure values have been fairly similar and stable across regions, land values on both coasts have accelerated significantly. This means that the driving force behind home price growth is the value of the land rather than the structure itself. Except for the Southwest, where land is relatively abundant, land’s share of total home value has increased in all regions.”
3 Anthony Downs, Real Estate and the Financial Crisis, URBAN LAND INSTITUTE, 2009, p. 57, Exhibit 2-16. Metropolitan Areas with the Highest and Lowest Median Home Prices in 2006, with San Jose-Sunnyvale-Santa Clara, Ca., at the top of the high list at $775,000 and Youngstown-Warren-Boardman-Oh-Pa., leading the low side at $81,500 (Data Source: The National Association of Realtors).
5 Les Christie, Las Vegas tops foreclosure list, CNNMONEY.COM, Feb. 5, 2008, available at http://money.cnn.com/2008/02/05/real_estate/zip_code_foreclosures/index.htm. “In 2004 alone, the median, single-family home price in the city grew by 47 percent, and that was followed by another 14 percent rise the next year. By 2006, the median home cost $317,400, near the national average.”
profits peaked at about 20% in 2004, accounting for opportunity costs, and had fallen to zero by 2007. For several years, Las Vegas’ foreclosure rates have stood highest in the nation. Spec buyers (aka non owner occupants) accounted for 60% of the foreclosures, about three times the rate of foreclosures among owner occupants.

Another reason foreclosure rates spiked among spec buyers is that they preferred subprime loans with low introductory, barely affordable ‘teaser’ rates. Subprime borrowing increased dramatically among all types of borrowers in locales with escalating home prices. Even buyers with credit scores good enough to have qualified them for prime mortgage loans took out subprime loans. Spec buyers hadn’t been too worried about the high long term cost of servicing this subprime debt once the ‘teaser’ period ended. Optimistically, they expected to sell at a whopping profit long before then, and prepay their acquisition financing from sale proceeds. As house prices cooled and then fell, buyers looking for a quick exit weren’t able to sell or refinance their subprime mortgages. Mix spec buyers with subprime loans and declining home prices, and you had a stomach churning recipe for a housing finance disaster.

As prices subside, spec buyers are more inclined to default than purchasers intent on occupancy. “This is because the vast majority of people who live in their homes plan to stay there for the long term and will not sell based on periodic economic corrections, thus keeping the market relatively stable.” Owner occupants search for the best available place to live and tend not to abandon their homes and forfeit their sunk costs at the first sign of prices leveling off. They tend to stay put at least until their current housing outlays exceed what they will need to spend to acquire their next domicile—taking into account all the expenses of selling, buying or renting, and moving to their next place, as well as the hardship of disrupting the lives of everyone in the household, and blemishing their own credit. Most purchasers planning to remain in their homes for a number of years tend to shrug off home price declines as temporary.

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10 Simon & Corkery, supra note 2.
11 Mortgage Bankers Association, Hidden Speculators.
12 Markham Lee, Subprime Mortgages Crossing Income and Credit Strata, SEEKING ALPHA, Oct. 12, 2007, available at http://seekingalpha.com/article/49701-subprime-mortgages-crossing-income-and-credit-strata. “The truth is that many affluent buyers used subprime loans to purchase more home than they could afford with a prime loan, make speculative real estate ‘investments’ and/or to withdraw more equity from their home than they could with a prime HELOC.”
13 Steven Malanga, Foreclosure Myths: Can the Media Handle the Truth?, REALESTATEMARKETS.COM, Oct. 29, 2008, available at http://www.realestatemarkets.com/articles/2008/10/foreclosure_myths_can_media_ha.html. “What's the difference? Well, ARMs draw a different kind of buyer, one who is often intent on selling or refinancing before rates re-set. We have some idea of the extent to which this kind of buyer drove sales at the height of the housing bubble. In 2005, according to data from the National Association of Realtors, speculative home purchases, that is, purchases of homes for investment purposes that the buyer didn’t intend to live in, amounted to a whopping 28 percent of all deals, and 22 percent in 2006.”
14 Randy Steinberg, Carving Flipping, in MULTIFAMILY TRENDS (URBAN LAND INSTITUTE) (Sept. 2005). Quoting Maria Cabildo, Executive Director of the East L.A. Community Corporation, a nonprofit, community-based organization that builds affordable housing in the predominantly Latino communities surrounding downtown Los Angeles.
15 Christopher L. Foote, Kristopher S. Gerardi, & Paul Willen, Negative Equity and Foreclosure: Theory and Evidence (FRB of Boston Public Policy Discussion Paper No. 08-3), SOCIAL SCIENCE RESEARCH NETWORK, June 5, 2008, p. 16, available at http://ssrn.com/abstract=1153413. The authors studied foreclosure history of 100,000 Massachusetts homeowners with negative equity in the 1990s, and found that only about 10% lost their homes through foreclosure. The borrower’s cash flow situation mattered greatly. Even for borrowers with negative equities, the net present value of defaulting on a mortgage can be negative.
Of course, owner occupants sometimes default, too, and lose their homes to foreclosure. But their defaults are almost always precipitated by events other than fluctuating house prices–job loss, divorce, illness, death or disability of the primary wage earner. Of course, they don’t need to stand passively by and lose their homes to foreclosure when house prices are buoyant. In good times they just need to face reality, list the home with a competent broker and prepare to relocate.

Perhaps if Las Vegas and other cities could have found a way to reduce the ranks of spec buyers in overheated markets, there would have been less overbuilding then and fewer foreclosures now. This paper recounts the main options potentially available to builders and lenders to detect and keep out spec buyers, including a law professor’s proposal for a government imposed alienability limit, a minimum holding period before sale. This is a good time to understand why these options range from imperfect to futile, lest they return like the undead of horror fiction to haunt us in the next dreadful housing cycle.

II. Real Estate Lenders and Mortgage Occupancy Fraud

The most favorable home mortgage terms are reserved for owner occupants both to advance home ownership, and in recognition of owner occupants’ lower delinquency rates. Owner occupants qualify for interest rates 40% lower than what banks would charge an investor, much smaller down payments, a two months reserve for property taxes and insurance instead of six months, and significantly less documentation since lenders require investors to demonstrate a history of success in managing properties.

Mortgage lenders insist that borrowers seeking to qualify for these advantageous terms affirm that they will move into the mortgaged property as their principal residence within 60 days of executing their loan agreements, and will continue occupancy for at least one year–barring extenuating circumstances beyond the borrower’s control or the lender’s written consent. Borrowers signing FNMA/FHLMC uniform deeds of trust or mortgages would also be in default for “materially false, misleading, or inaccurate information” in their loan applications, specifically including misrepresentations concerning occupancy as the borrower’s principal residence.

17 Occupancy Fraud and the Impact to the Mortgage Industry, BASEPOINT ANALYTICS LLC (2008), at 2.
19 Occupancy Fraud and the Impact to the Mortgage Industry at 6. “Because lenders typically charge a higher interest rate for non-owner occupied properties, which historically have higher delinquency rates, the lender often times will receive insufficient return on their capital, and are over-exposed on risk losses relative to what they would have expected for an owner occupied property.”
20 Id. at 3.
21 California Deed of Trust, FANNIE MAE/FREDDIE MAC (2009), ¶ 6.
22 Id. at ¶ 8
23 Id. “Material misrepresentations include, but are not limited to, representations concerning borrower’s occupancy of the property as Borrower’s principal residence.”
Many spec buyers commit occupancy fraud, lying about their intention to reside in the mortgaged property, to qualify for low or no down payment loans at favorable rates of interest. This enables them to benefit from leverage, magnifying their gains if home prices go up, and leaving the mortgage lender with the losses if prices go down. 

Current federal law provides enforcement agencies with authority to prosecute mortgage fraud. Penalties include possible loss of the property which would result in a forfeiture of the borrower's equity. State criminal laws empower state law enforcement agencies to pursue perpetrators of mortgage fraud, and many state civil laws empower private individuals and institutions to pursue mortgage fraud under Unfair and Deceptive Acts or Practices. Also, mortgage lenders are entitled to enforce owner occupancy provisions in their loan agreements allowing them to foreclose against breaching borrowers.

After-the-fact prosecutions don't prevent losses nearly as well as improved underwriting and mortgage lenders denying loans to spec buyers in the first place. On average, lenders will lose about one-third of their investment in a home or condo foreclosure. There are fairly good indicators of occupancy fraud risk but this requires loan originators to scrutinize loan application
carefully, increasing the costs of underwriting and delaying loan closings.33 “The mortgage application is, and always will be, the starting or ending point for fraud. The catastrophic collapse of the subprime market demonstrates a need for all lenders and investors to seriously reevaluate their current approach to risk management.”34

One tell-tale sign of fraud is when the borrower’s current monthly housing costs are much lower—200% or more—than the borrower’s projected monthly costs for the home being purchased.35 Another is when a loan applicant who says she is a renter has filed a tax return claiming homeowner deductions for property taxes and mortgage interest payments.36 A private firm called Basepoint Analytics markets software designed especially to ferret out these anomalies. Still, even the best available software doesn’t eliminate the need for extensive, skillful underwriting because 6 out of every 7 transactions the Basepoint software identifies as suspicious will prove to be legitimate.37

The increased underwriting effort may be cost justified. “The savings from detecting the fraudulent loan far outweigh the time to review,” notes Basepoint Analytics. But many lenders didn’t act as if they believed this in 2003-2006 when the rush was on to speed loan approvals in a climate of swiftly rising home prices that many lenders believed could never fall.38 Lenders could have done more to detect occupancy fraud, according to Frank McKenna, chief fraud strategist for Basepoint, “but the industry was very focused on volume.”39

Greater loan volume meant sizable loan origination fees and interest rate premiums for lenders making risky loans. Lenders competed with each other for investors’ funds and until the riskiness of poorly underwritten portfolios came to light through torrential rates of default and foreclosure losses, investors flocked to lenders offering the highest yields. Even as late as 2008, a lender whose short-term profits fell as it reduced loan volume by taking more time to underwrite loans, and rejected the riskiest loan applicants, stood to lose investors to its more aggressive competitors. Many investors would have perceived the lender’s claim to be reducing future losses from excessive risk taking as an excuse for its failure to produce competitive yields in the midst of what turned out to be a housing bubble.40

Unfortunately, lenders usually uncovered evidence of mortgage fraud only after the borrower had defaulted, and the lender or its agent carefully examined the original loan file.

33 RMBS Trends: Tighter U.S. Subprime Mortgage Underwriting Showing Up Slowly In Rated Securitizations, STANDARD & POOR’S (May 8, 2007) available at http://www2.standardandpoors.com/portal/site/sp/en/us/page.article/3,1,1,0,114844105394.html. In fact, the brisk and breezy underwriting practices of 2000-2007 enabled home loans to close in 30 days while current stringent bank underwriting has brought us back the 90-day closings reminiscent of the 1990s and earlier.

34 Kevin Coop, It's Time to Go Back to the Future, 68 MORTGAGE BANKING 117 (Nov. 11, 2007), 2007 WLNR 24019806. “A new wave of insidious mortgage fraud awaits us. As lending requirements change, fraudsters change their methods to evade new loan guidelines. With many lenders now requiring a 20 percent down payment and W-2s to prove income, Interthinx investigators are seeing an increase in silent-second mortgages and "self-employed" borrowers. We're also seeing an increase in family members and straw buyers 'rescuing' borrowers facing foreclosure, builder bail-outs and severe fallout from fraudulent condo conversions.”

35 McKenna, supra note 21. A telltale sign of occupancy fraud is, “Payment shock over 200%, Borrowers experiencing payment shock over 200% are more likely to be purchasing an investment property.”

36 Occupancy Fraud and the Impact to the Mortgage at 7-8.

37 Id at p.8.


Lenders reserve the right to call their loans, declaring the balance immediately due and payable, and to foreclose if the borrower doesn’t prepay. “Ordinarily, people who fib don't cost their lenders a dime. They tend to make their payments on time, just like most everybody else. But when those who use deception to obtain financing get in over their heads and can't—or won't—make their payments, their lenders stand to lose big, too.”41 As long as the borrower is making payments on time, a lender who happens to suspect mortgage fraud is put to a hard choice: keep collecting mortgage payments as if nothing is amiss or face a big financial hit by precipitating a foreclosure.

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41 Sichelman, supra note 25.
III. Buyer Fraud Against Tract Home Builders and Condo Developers

The Damage Spec Buyers Wrought. Spec buyers are good news and bad news for condo developers and tract home builders. A unit sold, even to someone who never plans to live in it, is better for the builder’s bottom line than a unit unsold—though only a minority of home builders admit to welcoming spec buyers.42 Yet, no builder or developer welcomes competition from spec buyers before successfully concluding its marketing and sales effort. Besides adding to the supply of unsold units, spec buyers can undercut the developer’s prices. And before the speculator sells, he or she will either rent the unit or leave it vacant. Neither of these moves supports developer efforts to create viable residential communities. Speculator buyers aren’t going to be good neighbors, lavish the same tender loving care on their properties as owner occupants, participate actively in home or condo association activities or join local service organizations, churches, bowling leagues or PTAs. several builders told the Wall Street Journal recently that they underestimated the percentage of their sales to investors, figuring maybe 10% when speculators were probably picking up a quarter of their inventory, often lying about their intentions regarding occupancy while signing documents promising they would reside in their homes.43

Spec buyers also send false signals to builders and developers regarding housing demand.44 Tract homebuilders and condo developers try to avoid building units too far ahead of demand first by taking non binding reservations and then entering purchase and sale agreements with potential buyers before commencing construction.45 One Miami condo developer explained how non owner occupants defaulting on their purchase contracts misled him into building a 1,646 unit condo building that had been 90 percent presold with non refundable deposits of 20 percent. Speculators fueled the market and then fled, abandoning their contracts as soon as prices began to level off.46 Of the first 500 units built, the Miami condo developer only sold 30, and many earlier buyers filed suit for a refund of their deposits.47 The developer’s buyers’ prospects for getting a loan have worsened now that FNMA won’t purchase a mortgage from a bank unless 70% of the units have been presold to residents rather than investors.48

42 Downs at 22, Exhibit 1-14. “Although many homebuilders tried to avoid selling to such speculators, the shares of home and condominium sales to speculator reached amazing levels in a few hot markets.”
44 Id. at 21. “Accelerating increases in home prices and commercial property prices in most parts of the nation from 2002 to 2005 stimulated further expansion of homebuilding, home purchases by former renters, home purchases by speculators interest only in flipping the units they bought, and greater investing in commercial real properties by institutional and other investors around the world.”
47 Ibid. Spec buyers are suing Florida condo developers for deposit refunds, claiming that the developers knew or could easily have learned that these buyers wouldn’t qualify for financing, and encouraged them to buy anyway, promising they could ‘flip’ their units profitably.

How Home Builders and Condo Developers Tried to Screen Out Home Flippers. Homebuilders are well aware of the risks posed by buyers who are non owner occupants. According to a 2005 survey of its members by the National Association of Homebuilders, four-fifths of all homebuilders try to confine sales to owner occupants. Home builders report a variety of means to screen out speculators:

- 64% reported prohibiting buyers from assigning their purchase and sale agreements or designating a nominee to take title at closing;
- more than half insert provisions in purchase and sale agreements prohibiting sales within the first year of ownership;
- 36% of builders reserved rights of first refusal to buy back homes sold within the first year at the builder’s selling price;
- 36% refused to allow any units to be rented within the first year after purchase;
- 18% wouldn’t sell more than one home to buyers with the same last names;
- 18% used a variety of other measures, including steep fees for homes resold within the first year.
- Some builders reserve the right to disclose suspected mortgage fraud to the buyer’s lender.

Condo developers and home builders seldom place the types of restrictions mentioned above into recorded deeds. Instead, these restrictions tend to appear only in purchase and sale contracts, unrecorded. There are two reasons for this. First, deed restrictions are best reserved for relatively permanent restraints, not transitory ones. Developers and builders have no reason to preclude non owner occupants from buying individual units in the resale market after they have sold out all their units. During the initial sales push for a new development, spec buyers can impact prices enormously because so many units are on the market at once. After the initial sell out, it is unlikely that individual unit buyers will be placing their units on the market all at once, thereby reducing the chances that spec buyers could skew prices throughout the project.

Second, developers and builders want to avoid impairing the marketability and value of their units. By placing either a contract or deed restriction in the public land records that limits occupancy by non owners, developers put subsequent purchasers and mortgagees on constructive notice, potentially clouding the titles of all grantees. Before buying or financing a unit subject

50 Ibid.
51 CentexHomes.com, Important Legal Notices/Privacy Policy, http://www.centexhomes.com/Legal.aspx (last visited May 24, 2009). “Sharing of personal information with third parties. Individuals or companies outside of the Centex family of companies are considered third parties. Mortgage lenders are permitted (and sometimes even required) to share customer information with third parties for certain purposes, such as servicing customer relationships, fraud and risk management, and responding to transaction requests…We also share personal information as legally required. We may share personal information with law enforcement agencies or other third parties to prevent or investigate suspected fraudulent activities.”
53 WILLIAM H. PIVAR & ROBERT J. BRUSS, CALIFORNIA REAL ESTATE LAW (1997), 229-31. “The recording statutes provide that, after being acknowledged, any instrument or judgment affecting title to, possession of, or rights in real property may be recorded. Recording a document gives the whole world constructive notice of the fact recorded.”
to a recorded restriction like this, observant purchasers might have no problem confirming in a purchase and sale agreement their personal immediate intentions regarding residency but might balk at accepting a deed restriction that could limit the market for their homes when they wish to sell sometime in the future and might also deter a mortgage lender from financing their present purchase or an eventual sale.

Imagine, though, a developer or builder determined to stamp out spec buying by any lawful means, regardless of the potentially adverse impact on sales. The most effective way of doing this would be through a recorded deed restriction calling for title to revert to the grantor if a non owner occupant tried to sell within, say, six months or a year of acquiring title.

Alternately, condo regimes often prohibit owners from renting their units. Such restrictions upon rentals are contemplated in state condominium laws, may appear in the Declaration of Condominium in deeds from the developer to individual units, or by laws enacted by the homeowners’ association according to procedures outlined in the documents that established the condominium regime.

Doctrinally, restraints on alienation fall into one of three broad categories: disabling, forfeiture, and promissory. A disabling restraint invalidates the grantee’s attempt to transfer property contrary to its terms. The transferee takes nothing; title remains intact with the grantee, unburdened by the purported transfer. Under a forfeiture restraint, the grantee’s title terminates following a prohibited transfer and title reverts to the grantor. Forfeiture provisions could take the form of a reservation by the conveyor of a power of reentry, exercisable when the grantee tries to sell in disregard of the restriction. The third type, promissory restraints, consist of covenants, conditions or restrictions on the ownership or use of property transferred, enforceable by injunction or damages against the breaching owner. The grantee that violates a promissory restraint becomes liable to the grantor for damages or injunctive relief.

The burden of disabling and forfeiture restraints falls upon those to whom the grantee attempted to convey in violation of them. Generally, courts are extremely wary of disabling or

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54 Joseph E. Adams, Condo Act Requires Insurance, FORT MYERS THE NEWS-PRESS (May 25, 2006), available at http://www.becker-poliakoff.com/pubs/articles/adams/adams_2006_05_25.pdf. “Section 718.110(13) of the Florida Condominium Act was amended effective October 1, 2004 to provide that any amendment restricting unit owners’ rights relating to the rental of units applies only to unit owners who consent to the amendment, and unit owners who purchased their units after the effective date of that amendment.” Joseph E. Adams is from the firm of Becker & Poliakoff and mainly practices in the area of association law.

55 Mullin v. Silvercreek Condo. Owner's Ass'n, Inc., 195 S.W.3d 484 (Mo.App. S.D., 2006) (“Nothing in this [s]ection 6.2 is intended to restrict the right of any condominium unit owner to rent or lease his condominium unit from time to time”).

56 Villas West II v. McGlothin, 885 N.E.2d 1274 (2008) (The homeowner's parents purchased a home in a planned unit development; a covenant in the deed prohibited them from leasing their residence).

57 Kroop v. Caravelle Condo., Inc., 323 So. 2d 307, 309 (Amendment prohibiting leasing of unit more than once during period of ownership was reasonable and could be applied to owner who purchased unit before amendment was adopted because owner purchased subject to all terms of declaration including term that declaration could be amended).

58 Merrill L. Schnebly, Restraints Upon the Alienation of Legal Interests, 44 YALE L. J. 961, 963-64 (1935).

59 61 Am. Jur. 2D Perpetuities, Etc. § 90 (promissory restraints).

Dieckmeyer v. Redevelopment Agency of the City of Huntington Beach, 127 CalApp.4th 248, 260-61 (2005) (Equity share, which condominium purchaser was required to pay if loan city made to purchaser under its affordable housing program became due, was not due on purchaser's prepayment of loan; prepayment was not a breach of the loan documents, covenants, conditions, and restrictions or any law, nor was prepayment one of the events listed in the acceleration clause making loan due).
forfeiture restraints, some courts treating them as invalid per se while other courts tend to grant enforcement subject to judicial determinations of reasonableness, case by case. The venerable doctrine barring restraints against alienation would probably bar enforcement of a restriction calling for title to revert to the grantor if the grantee failed to occupy the unit within a specified time.

Generally, no-lease restrictions avoid characterization as unlawful restraints on alienation by virtually always being made enforceable only as promissory restraints. The penalties for breach are usually monetary and fall on the condo unit owner who violates the no-lease restriction. Courts generally uphold promissory restraints upon rentals as reasonable restraints on alienation unless the monetary penalties are horrifically disproportionate to the harms done. Rarely are provisions prohibiting rentals cast as disabling restraints invalidating the tenant’s lease or as forfeiture restraints, forcing the unit owner to surrender title to the condo association or prohibiting sale to a grantee who admits no interest in ever occupying the unit.

Sometimes, courts allow gift givers to impose forfeiture and disabling restraints against ungrateful donees and their inattentive lenders when the grantor had marked down the purchase price to account for the diminished value of the restricted conveyance. Similarly, courts uphold

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60 WILLIAM B. STOEBUCK & DALE A. WHITMAN, THE LAW OF PROPERTY 30 (3d ed. 2000). “Provisions purporting, without any limitation as to duration or scope, to prohibit the transfer of a present fee simple absolute so-called 'disabling restraints'-or to defeat or terminate what would otherwise be a present fee simple absolute upon transfer-so-called 'forfeiture restraints'-are universally held void in the United States.”

61 17 Wash. Prac., Real Estate § 1.26 (2d).

Richard Seigler, Cooperative and Condominiums, 226 N.Y.L.J. (Nov. 7, 2001). “Generally, New York courts will uphold restrictions on the alienation of property if such restrictions are deemed reasonable. The reasonable test consists of three main factors: price, duration, and purpose (citing Metropolitan Transportation Auth. v. Brunken Realty Corp., 67 N.Y.2d 156, 150 (1986)).”

62 See, e.g., Bankers Trust Co. of California, N.A. v. Bregant, 261 Wis.2d 855, 661 N.W.2d 498 (Wis. App. 2003).

63 Kelley v. Broadmoor Co op. Apartments, 676 A.2d 453 (D.C. 1996) (Court upheld condo association levy of a 5% surcharge on the monthly association dues of any owner during the first year she rents her unit, and an additional 5% for each additional year she rents, up to a maximum of 25%).

64 Laguna Royale Owners Ass’n v. Darger, 119 Cal. App.3d 670 (1981) (Court set forth these criteria for testing the reasonableness of restrictions: “(1) whether the reason for [the restriction] is rationally related to the protection, preservation or proper operation of the property and the purposes of the Association as set forth in its governing instruments and (2) whether the power was exercised in a fair and nondiscriminatory manner. Another consideration might be the nature and severity of the consequences of application of the restriction (e.g., transfer declared void, estate forfeited, action for damages.”)

65 Jordan I. Shifrin, No-Leasing Restrictions on Condominium Owners: The Legal Landscape, 94 Ill. B. J. 92 (Feb. 2006). Condominium associations are adopting provisions eliminating rentals, and legal challenges to these restrictions are seldom successful.

Flagler Fed. Sav. & Loan Ass’n v. Crestview Towers Condominium Ass’n, Inc., 595 So. 2d 198, 200 (Fla. Dist. Ct. App. 1992). The original recorded Declaration of Condominium prohibited owners from leasing their units without Association approval but excluded institutional mortgagees acquiring title-in 1970. The plaintiff became a mortgagee of two units. Later, in 1984 the Association amended the Declaration to prohibit leasing entirely. In 1987 the plaintiff acquired title to one of the units by foreclosure and the other by quit claim deed in lieu of foreclosure. It attempted to lease the units, the Association objected, the plaintiff filed a declaratory judgment. The court held the plaintiff bound by the no rental rule in the amended Declaration like other unit owners who acquired title prior to the amendment.

18 Wash. Prac., Real Estate § 12.9 (2d) (“no such restraint should be imposed upon the owners of Washington condominium units.”).

66 Error! Main Document Only.Bankers Trust Co. of California, N.A. v. Bregant, 261 Wis.2d 855, 661 N.W.2d 498 (Wis. App. 2003). (HOA denied the right to enjoing mortgage foreclosure sale to buyer with no intention of occupying the unit purchased. Denying mortgagee the right to sell would impair marketability unduly. The HOA could enforce its by law against renting if the new owner violated the restriction.)

67 Alby v. Bane One Financial, 156 Wash.2d 367, 373 (Wash. 2006). Aunt and uncle deeded a family farm to their niece and her husband for $15,000 that was worth $100,000 at the time. They conveyed by fee simple determinable, reserving a right of reverter if the grantees sold to a non-family member or mortgaged the property while the aunt and uncle were still alive. Five years later, the grantees mortgaged the property for over $100,000 and soon defaulted. The lender foreclosed. The aunt brought suit to quiet title in herself (the uncle had since passed away), and prevailed. The foreclosing lender would then have had only a personal cause of action against the niece and her husband for repayment of the debt.
restrictions imposed by the promoters of subsidized housing to preclude occupants capturing the benefit of the subsidy by selling or leasing at market prices and frustrating the purpose of subsidizing housing to make it affordable in the first place.

By contrast, the doctrine barring forfeiture restraints against alienation would almost certainly preclude developers and builders who sold to spec buyers at market prices from deeding property in fee simple determinable, reserving the right to recapture title to properties sold by non owner occupants contrary to the agreed ‘black out’ period on sales. Instead, developers are entitled to reserve rights of first refusal. They don’t have to match the price the spec buyer may contract to receive from a third party buyer. But developers seeking to exercise rights of first refusal to prevent spec buyers from realizing quick resale profits need to reimburse the spec buyer’s purchase price to avoid perpetrating a forfeiture.

IV. Should Governments Impose Alienability Constraints on Spec Buyers?

In one of the most often cited law review articles ever written, Guido Calabresi and Douglas Melamed pointed out that the state not only grants basic entitlements. Government must also decide how individuals may enforce those entitlements, and there are three choices. Calabresi and Melamed characterized these as property, liability and inalienability entitlements. The owners of an entitlement protected as a property right have the prerogative of selling or not, and of naming a price of their own choosing. A liability rule empowers others to interfere with or destroy an entitlement (like the right not to be run down by a careless driver) upon payment of compensation through a government-determined procedure. An entitlement becomes inalienable when the state prohibits or limits its transferability between willing buyers and sellers.

University of Chicago Law Professor Lee Anne Fennell in a recent a law review article noted that law and economics scholars have confined most of their writing to property and liability rules, and for the most part overlooked the potential positive role that restricting alienability might play. She had in mind situations where market driven transactions are usually thought appropriate but where for special reasons a norm of inalienability could usefully discourage potential resellers from acquiring an asset in the first place. She explores “conditions under which alienability limits offer a more promising point of intervention than

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69 City of Oceanside v. McKenna, 215 Cal. App. 3d 1420, 1427, 264 Cal. Rptr. 275 (1989). The court upheld restrictions requiring owner occupancy and precluding owners from renting their units in a subsidized housing project constructed in a redevelopment area as replacement housing for demolished low and moderate income units. "The disputed restrictions clearly and directly are related to the stated purposes of maintaining a stabilized community of low and moderate income residents and discouraging speculation by real estate investors."
70 James Jacobson, The Fight Against Speculation, ALLBUSINESS.COM, Dec. 21, 2008, available at http://www.allbusiness.com/economy-economic-indicators-economic-indicators-new/11728820-1.html. "The addition of the 'first right of refusal' to new home sale contracts essentially allowed for a purchaser to re-sell their home by first offering it back to the developer, and in most cases, at the price that was originally paid for by the purchaser."
72 Fennel, supra note 49.
73 Id. at 1406.
limits on acquisition, use, or exclusion.”

Could alienability rules be superior to limitations on use or sales in discouraging spec buyers from purchasing units in the first place? As Professor Fennell points out, property can be acquired in a quest for wealth accumulation or as an item for personal use and enjoyment. Most home and condo owners acquire property for use, and only incidentally as investments. Spec buyers, by contrast, are only interested in profitable resale. Restricting their alienability options should discourage their acquisitions in the first place, relieving lenders and developers from having to spend so much energy trying to screen them out.

To date, no government has initiated a measure to render property inalienable in the hands of non owner occupants pretending to become residents, the way, for instance, that sales of stolen goods or endangered species are prohibited even to bona fide purchasers. Instead, probably the most effective disincentives to spec buying are the provisions in the federal tax code greatly favoring home ownership, and denying spec buyers capital gains treatment if they sell too soon.

To probe the implications of a government imposed alienability restriction on spec buyers, consider as an example University of Nevada Law Professor Ngai Pindell’s 2006 proposal of a locally enacted “anti-speculation zoning ordinance.” Enacting such legislation on a local basis makes sense because of the uneven distribution “within states and within cities in each state” of foreclosures and spec buying. The proposed ordinance would preclude “first purchasers of residential property in newly constructed developments of a certain size” from selling the property for three years “in medium and large-scale communities of approximately twenty or more units. The ordinance would apply to both attached and detached single-family

74 Id. at 1408.
75 63C Am. Jur. 2d Property § 34. “The theft of goods or chattels does not divest one who owns, or has title to, such property from his or her ownership of the property, since one cannot make good title to that which he or she does not own. The owner may follow and reclaim the stolen goods wherever he or she may find them, even if such goods have been changed or improved. If possession of the stolen goods by an innocent subsequent purchaser may be deemed lawful, it is rendered unlawful by his or her refusal to honor a demand by the true owner for their possession. Even though such a purchaser may be treated as having title and the right to possession as against everyone but the rightful owner, a sale by the thief or by any person claiming under the thief does not vest any title in the purchaser as against the owner, though the sale was made in the ordinary course of trade and the purchaser acted in good faith…The owner may, through an appropriate action or proceeding, recover the stolen goods, their proceeds, or their value, either from the thief, or from any other person who has not acquired such title and into whose possession they have come, whether innocently or otherwise.”
77 Gerald J. Robinson, Fed. Inc. Tax. Real Estate 1.01 (Overview and Planning). “Part of our heritage is rooted in Coke's declaration, "A man's home is his castle." Pride of home ownership runs deep in the American character. Indeed, from colonial times to the present, virtue has somehow been associated with property ownership. The tax favoritism that Congress has bestowed upon homeowners is a reflection of these attitudes and of the immense political power of homeowners. Homeowners are accorded numerous tax privileges not allowed to the landless tenant. For example, the homeowner is permitted to deduct direct payments of real estate taxes (26 USC § 503) and mortgage interest (26 USCS § 163(h)). Yet, residential rent is a wholly nondeductible “personal” expense, even though part of it is indirectly attributable to the landlord's taxes and mortgage interest. Similarly, the virtue of home ownership is rewarded when the owner sells a home at a gain. Tax on the gain may be escaped entirely if it does not exceed $250,000 or $500,000 for married taxpayers filing a joint return (26 USCS § 121). No other personal asset is so favored. Indeed, the favoritism is so marked that it was in substantial measure responsible for sparking a nationwide movement to cooperative and condominium apartment ownership, which enjoy similar tax blessings.”
78 26 U.S.C. § 121(a) (“Exclusion—Gross income shall not include gain from the sale or exchange of property if, during the 5-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating 2 years or more”)
79 Downs at 69 (Exhibit 3-5, California Foreclosures As Percentage of households for Selected Counties, showing a foreclosure rate high of 14.9% in San Joaquin and a low of 1.2% in San Francisco. “Overall data for Boston, Milwaukee, and the entire United States are shown as benchmarks that were not greatly influenced by speculation.”). 22 (Exhibit 1-14, Speculation Indicators. Share of Mortgages Made for Homes Sold to Nonoccupiers, in the Nation and in 15 Metropolitan Areas, 1999-2006).
housing.\textsuperscript{80} Professor Pindell’s proposal was preliminary and suggestive. Though he didn’t purport to spell out all the details, he recognized the need for administrative exceptions “for those purchasers truly intending to hold the property for three years, but unable to complete the period because of extenuating circumstances. The inclusions of such exceptions to the ordinance would likely necessitate an administrative system to evaluate the merit of waiver claims, monitor compliance, and conduct enforcement through civil or perhaps criminal penalties.”\textsuperscript{81}

The professor thoughtfully acknowledges that “exceptions to an anti-speculation measure threaten to swallow the rule as local governments would face understandable pressure to approve individual or categorical exceptions to the application of the ordinance for hardship and similar unforeseen occurrences. The number of people entitled to exceptions could outnumber those not entitled to exceptions, and the administrative burden of identifying bona fide cases for exception could be overwhelming and threaten to outweigh the benefits of the legislation.”\textsuperscript{82}

Professor Pindell’s outline of an anti spec buyer ordinance leaves open “the appropriate resale limitation period and the appropriate punishment for violations.”\textsuperscript{83} To comply with due process standards, an ordinance would probably have to be recorded in the chain of title of each affected property in order to invalidate the titles of those who purchased from spec buyers within the three year blackout period.\textsuperscript{84}

Would real estate closing attorneys, brokers or title insurers be responsible for warning the buyers they represented or insured of the existence and implications of the ordinance? Maybe so. Professor Pindell suggests: “The local government could require that an affidavit of compliance be included with the sales contract or other aspects of the purchase process. A person making a false statement on the affidavit or failing to comply with the instructions of the affidavit would be subject to civil or criminal proceedings. Local government might monitor buyer activity through property tax payments or deed recordings.”\textsuperscript{85}

Since lenders and developers are in a far better position to recognize spec buyers than most city administrators, and have a greater incentive to do so, Professor Pindell advances the possibility that developers and builders could be the primary initiators of anti-spec sales provisions, and through development agreements or by other means, enlist local governments to assist with enforcement,\textsuperscript{86} the way private deed restrictions are enforced by local governments in Texas.\textsuperscript{87}

On balance, alienability limits would not be a sensible response to deter spec buying. For starters, there is the cost to the government of enforcement and possibly of recording notices of specifications.

\textsuperscript{81} Id. at 547.
\textsuperscript{82} Id. at 595.
\textsuperscript{83} Id. at 547.
\textsuperscript{85} Pindell at 594.
\textsuperscript{86} \textit{Ibid}.
\textsuperscript{87} See e.g., Tex. Loc. Gov’t Code Ann. § 212 (2009); 15 Houston Code. §§ 10-551-10-555; The City of Houston is authorized to enforce by suit for injunction, restrictions that affect subdivisions within the City.}
the ordinance in the chains of title of all affected properties.

The assumption that a municipally imposed minimum holding period would deter spec buyers is questionable. After all, this is a class of buyers willing to risk FBI investigations and federal prosecutions for mortgage fraud, and the possibility of having their mortgages foreclosed for violating pledges of owner occupancy. The sanctions for violating a local ordinance calling for a minimum holding period pale by comparison. It is highly improbable that local enforcement would be well funded and effective.\(^8\)

While such an ordinance might not deter spec buyers it could discourage buyers from acquiring personal residences anywhere in the enacting jurisdiction. The buyers’ and mortgagees’ title insurance costs would be greater since proof would be required that they were not buying or financing into a violation. And purchasers forced to sell within the black out period due to changing life circumstances—divorce, death, job relocation, financial stress—would need to procure an administrative exception from the local government. They couldn’t safely conclude a sale until the exception was granted. This process could result in a costly delay in a market where house prices were steadily declining, especially if the local government was slow to respond.

Affected owners could find themselves locked into a less than optimal situation for a period of years. At least with privately imposed constraints, developers and lenders could grant waivers to spec buyers should there come a time when market conditions make spec buyers more welcome.

Consider the adverse consequences Professor Pindell’s ordinance would have wrought in his home town of Las Vegas, if enacted in 2006. Precluding spec buyers from selling for three years might have deterred some buyers from entering the then overheated market in the first place but would probably also have added to the stock of unsold, abandoned and foreclosed houses once the market plunged.

Inalienability rules are a bad idea when designed to hold back the shifting sands of market values. Richard Posner reminds us that; “speculation is a valid method of aligning prices with underlying values.”\(^9\) In 2005 spec buyers were disdained for driving prices out of reach for home seekers. Though spec buyers were not held in high regard when their bidding was perceived as fueling a dangerously expanding housing bubble, speculators are now warmly welcomed for bidding prices off of historic lows. There is a good reason for this. A bursting housing bubble causes pain to many, starting with home owners, builders, developers and lenders. Conversely, spec buyers who snap up houses at severely depressed prices are seen as helping to avert a free fall deflation in house prices, and the job layoffs and bank insolvencies that deflation can bring.\(^0\)

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\(^8\) WILLIAM FULTON, GUIDE TO CALIFORNIA PLANNING 139-40 (2d ed. 1999). “Even when code violations are caught and cited, local governments have difficulty motivating property owners to comply with the law. The property owners may pay a fine and promise to clean up their act, but in all likelihood they won’t change the way they do business—for two reasons. One is that code enforcement officers are usually overworked, and property owners know it will take a long time before the officers get around to doing follow-up. The second reason is that the threat of further punishment usually doesn’t exist.”


In the present post-bubble era, speculative buyers are playing a vital function in stabilizing falling prices, especially where they are putting a floor on house prices by actively bidding on foreclosed homes.91 Some housing markets had become virtually moribund where prices once soared and then collapsed to less than half their former levels, Phoenix among them. These markets are being resurrected with the help of absentee investors purchasing nearly the same ratio of homes as when house prices were peaking.92 Perhaps in tacit recognition of the important role of spec buyers in the current market, Fannie Mae and Freddie Mac will purchase up to ten home mortgages owned by the same borrower where previously they would have purchased no more than four.93 Often, the foreclosed borrowers become tenants in the very houses they once owned, pay rents at levels well below their previous mortgage payments, and hope someday to buy back their homes.94

Though genuine homebuyers may not miss the challenge of trying to outbid home flippers in the housing market, builders and developers welcome any entrants into the ranks of home buyers who can help to elevate prices above production costs so homebuilding can become profitable once more.95 A seasoned California real estate broker specializing in branded real estate, resort and luxury condo sales recently remarked: “One thing is for certain, we sure miss those speculators.”96 Had an ordinance been enacted in Las Vegas like the one Professor Pindall suggested, it would almost certainly have been repealed by now at the insistence of real estate brokers, home builders, mortgage lenders and home owners. An inalienability ordinance would no longer be sustainable because spec buyers are now welcome as much needed rescuers of deflated housing markets.

91 Jacobson, supra note 66.
92 David Streitfeld, Amid Rubble of Housing Bust, One City Begins a New Frenzy, N.Y.TIMES, 05/24/2009, p. 19, col. 4.
94 Streitfeld, supra note 86. Brewer Caldwell (a property management firm) has bought about 125 houses this year for its clients. Only a quarter had owners who were living there already and willing to stay on as tenants.
96 Streitfeld, supra note 87.