Should We Ban or Welcome SPEC Home Buyers

George Lefcoe
SHOULD WE BAN OR WELCOME “SPEC” HOME BUYERS?

This article 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; instead, they hope 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—far more quickly than would owner occupants. If spec buyers had 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 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, especially with the aid of specially designed software and a 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, I describe the means used by homebuilders to restrain home flippers. I also explain 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, I 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, I conclude that an alienability 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.

By George Lefcoe*

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I. SPEC BUYERS CONTRIBUTED TO HOUSE PRICE VOLATILITY

When house and condo prices were soaring in many regions of the United States from 2004 to 2006, speculating ("spec") buyers climbed on board for the all-too-fleeting joyride. They hoped to profit from reselling swiftly without ever moving in, and they lied to lenders and developers, claiming their acquisitions were for their own use and occupancy. Spec buyers (a.k.a. non-owner occupants) 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 would not be able to recoup their invested equity plus their share of the closing costs. With spec buyers forming about a quarter of the market, University of Texas Economics Professor Stan Leibowitz explains: "[The number of spec buyers is] large enough that if only a minority of speculators defaulted when housing prices stopped increasing, it could have explained all or most of the entire increase in foreclosures started." To see how this played out in one market, consider Las Vegas where home and condo prices rose sharply in 2004–2005, peaked in 2006, and then began a slow descent, dropping 40–50% by 2009. Their profits peaked at about 20% in 2004,

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1. See Anthony Downs, Real Estate and the Financial Crisis: How Turmoil in the Capital Markets Is Restructuring Real Estate Finance 56–59 & exh.2-16 to 2-17 (2009) (describing the variation in median home prices and the rate of change in home prices in various metropolitan areas since 1997); Dennis Cauchon, USA Today, Why Home Values May Take Decades to Recover (2009), http://i.usatoday.net/news/graphics/housing_prices/home_prices.pdf ("The housing bubble began in 1998, peaked in 2006 and burst in 2007."); see also Andrea Pescatori & Bethany Tinlin, Home Prices, Econ. Trends, Apr. 7, 2008, at http://www.clevelandfed.org/research/trends/2007/0407/ET_apr07.pdf ("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.").

2. See Ruth Simon & Michael Corkery, Speculators May Have Accelerated Housing Downturn, Wall St. J., Feb. 6, 2008, at B8 (reporting that results of a study in which Fitch Ratings found that, in two-thirds of the subprime loan cases studied where borrowers with good credit scores defaulted within the first twelve months, the borrowers had never moved into the properties they said they were going to occupy in their loan applications)


accounting for opportunity costs, but had fallen to zero by 2007.\textsuperscript{7} For several years, Las Vegas's foreclosure rates have stood highest in the nation.\textsuperscript{8} Spec buyers accounted for up to 60\% of the Las Vegas foreclosures,\textsuperscript{9} which is about three times the rate of foreclosures among owner occupants.\textsuperscript{10}

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 qualify them for prime mortgage loans took out subprime loans.\textsuperscript{11} Spec buyers were not 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 to prepay their acquisition financing from sale proceeds.\textsuperscript{12} As house prices cooled and then fell, buyers looking for a quick exit were not able to sell or refinance their subprime mortgages. Mix spec buyers with subprime loans and declining home prices, and you have a stomach churning recipe for a housing finance disaster.

As prices subside, spec buyers are more inclined to default than purchasers intent on occupancy, “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.”\textsuperscript{13} 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.\textsuperscript{14} Most purchasers planning to remain in their homes for a number of years took for granted that house prices would keep rising—regardless of whether they actually intended to stay in their current housing units for years, or eventually sell them and buy one more expensive. The truth, however, is that many affluent buyers used subprime loans to purchase more home then 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 [home equity line of credit]."

\textsuperscript{7.} Id. at 259–260 & fig.7.
\textsuperscript{9.} Simon & Corkery, supra note 2.
\textsuperscript{10.} BASEPOINT ANALYTICS LLC, OCCUPANCY FRAUD AND THE IMPACT TO THE MORTGAGE INDUSTRY 7 (2008) (on file with author) (reporting that an analysis conducted by the Mortgage Bankers Association in 2007 “indicated that investment properties represented up to [three] times the level of risk of default than owner occupied properties”).
\textsuperscript{11.} Markham Lee, Subprime Mortgages Crossing Income and Credit Strata, SEEKING ALPHA, Oct. 12, 2007, 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 then 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 [home equity line of credit].”).
\textsuperscript{12.} See Steven Malanga, Foreclosure Myths: Can the Media Handle the Truth?, REALCLEARMARKETS, Oct. 29, 2008, http://www.realclearmarkets.com/articles/2008/10/foreclosure_myths_can_media_ha.html (explaining that adjustable-rate mortgages tend to draw buyers who expect to sell or refinance before the mortgage rates reset).
\textsuperscript{13.} Randy Steinberg, Curbing Flipping, MULTIFAMILY TRENDS, Sept.–Oct. 2005, at 20, 23.
\textsuperscript{14.} Cf. Christopher L. Foote, Kristopher S. Gerardi & Paul Willen, Negative Equity and Foreclosure: Theory and Evidence, 64 J. URB. ECON. 234, 240–41 (2008) (studying the foreclosure history of 100,000 Massachusetts homeowners with negative equity in the 1990s). The study found that (1) only about 6.4\% of these homeowners lost their homes through foreclosure; (2) the borrowers’ cash flow situations greatly degraded; (3) the vast majority of these defaults were due to the mortgage rates resetting at a much higher and less affordable rate; and (4) the decline in equity and cash flows both start and end before the defaults.

years tend to shrug off home price declines as temporary. 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, or the death or disability of the primary wage earner. Of course, they do not 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 during the housing boom and fewer foreclosures now. This article 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 what these options can accomplish, to appreciate their limitations, and to realize why we cannot expect much interest in them during a house price deflation.

II. REAL ESTATE LENDERS SUFFER FROM AND ARE GOOD COST AVOIDERS OF MORTGAGE OCCUPANCY FRAUD

The most favorable home mortgage terms are reserved for owner occupants both to advance home ownership and to recognize the lower delinquency rates of owner occupants. Owner occupants qualify for mortgages with interest rates 40% lower than what banks would charge an investor, much smaller down payments, two months reserve to cover 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 sixty 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 Fannie Mae (FNMA) or Freddie Mac (FHLMC) uniform deeds of trust or mortgages are in default if they provide “materially false, misleading, or inaccurate information” in their loan applications, specifically including misrepresentations concerning occupancy as the borrower’s principal residence.
Many spec buyers commit occupancy fraud, lying about their intentions to reside in the mortgaged property in order to qualify for low- or no-down payment loans with favorable interest rates. This enables them to benefit from leverage, magnifying their gains if home prices go up while 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 the 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 as unfair or 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 do not prevent losses nearly as well as improved

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Borrower’s occupancy of the Property as Borrower’s principal residence.


21. See The Prieston Group Finds Occupancy Fraud Dominates Claims, Nat’l Mortgage News, Sept. 19, 2005, at 28 (reporting that over half of the mortgage fraud claims filed with the Prieston Group in the first half of 2005 involved occupancy fraud; the Prieston Group is a firm that provides electronic services on behalf of lenders and insures them against loss due to fraud); Lew Sichelman, Lenders Looking at ‘White Lie’ Fraud, Origination News, Jan. 2006, at 6, 6 (reporting that in 75% of the insurance claims involving occupancy fraud, the fraud was committed by borrowers who did not want to pay investor interest rates).


23. See Joshua Rosner, Housing in the New Millennium: A Home Without Equity Is Just a Rental With Debt 29 (2001), http://ssm.com/abstract-1162456 (“The virtuous circle of increasing homeownership through greater leverage has the potential to become a vicious cycle of lower home prices due to an accelerating rate of foreclosures caused by lower savings.”).

24. See, e.g., 18 U.S.C. § 1341 (2006) (mail fraud); 18 U.S.C. § 1343 (2006) (wire fraud); 18 U.S.C. § 2314 (2006) (transfers in interstate or foreign commerce of fraudulently obtained funds or goods); 18 U.S.C. § 1344 (2006) (defrauding federally chartered or federally insured institutions); 18 U.S.C. § 1014 (2006) (making false statements or reports, including overvaluations, to influence federal agencies or federally chartered or federally insured institutions); United States v. Hitchens, 62 F. App’x 417, 418–19 (3d Cir. 2002) (holding that the prosecutor did not need to show that the real estate agent personally used the mails or wires to convey fraudulent documents as long as she knew that the mails or wires would be used in the ordinary course of business).

25. See, e.g., United States v. 874 Gartel Drive, 79 F.3d 918, 923–24 (9th Cir. 1996) (affirming order of forfeiture where the owners falsely reported their income in order to obtain a loan from a federally insured financial institution and the owners knew, or were willfully blind to, the false statements in the loan application); United States v. 403½ Skyline Drive, 797 F. Supp. 796, 798 (C.D. Cal. 1992) (granting summary judgment in forfeiture action where owner had misrepresented his employment status on his loan application, even though loan was not in default).


27. Investors Sav. & Loan Ass’n v. Ganz, 416 A.2d 918, 921–22 (N.J. Super. Ct. Ch. Div. 1980) (“[The court does] not find that the owner occupancy requirement is unconscionable or inequitable. Given plaintiff’s purpose to promote home ownership, its policy of not making loans except for that reason, and the language of [the statute], it cannot be said that its requirement of owner occupancy as a condition for the granting of a mortgage loan is unjust. Defendants were fully aware of this condition when they freely and voluntarily entered into the mortgage transaction. Furthermore, plaintiff’s fear that the lack of owner occupancy might jeopardize its security is not unreasonable. Since defendants have defaulted, plaintiff has the right to accelerate the due date of the unpaid balance of the debt and to require payment thereof. Such payment having not been made as demanded, summary judgment of foreclosure is appropriate.”).
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 they require loan originators to scrutinize loan application carefully, increasing the costs of underwriting and delaying loan closings. "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."

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. 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. A private firm called BasePoint Analytics markets software that is specially designed to ferret out these anomalies. But even the best available software does not eliminate the need for extensive, skillful underwriting, because six out of every seven transactions the BasePoint software identifies as suspicious prove to be legitimate.

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 did not 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. Lenders could have done more to detect

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28. See Mortgage Bankers Ass'n, Lenders' Cost of Foreclosure 2 (2008), http://www.mortgagebankers.org/files/Advocacy/2008/LendersCostofForeclosure.pdf ("While losses can vary widely, several independent studies find them to be generally quite significant: over $50,000 per foreclosed home or as much as [30-60%] of the outstanding loan balance.").

29. RMBS Trends: Tighter U.S. Subprime Mortgage Underwriting Showing up Slowly in Rated Securitizations, Standard & Poor's (May 8, 2007), (on file with author). In fact, the brisk and breezy underwriting practices of 2000-2007 enabled home loans to close in thirty days while current stringent bank underwriting has brought us back the ninety day closings reminiscent of the 1990s and earlier.

30. Kevin Coop, It's Time to Go Back to the Future, Mortgage Banking, Nov. 1, 2007, at 118. According to the chief executive officer of Interthinx, a company that supplies risk mitigation and regulatory compliance tools to the financial services industry:

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%] down payment and W-2s to prove income, Interthinx investigators are seeing an increase in silent-second mortgages and "self-employed" borrowers. [Interthinx is] also seeing an increase in family members and straw buyers "rescuing" borrowers facing foreclosure, builder bail-outs and severe fallout from fraudulent condo conversions.

Id.

31. BasePoint Analytics LLC, supra note 10, at 7 ("Borrowers experiencing payment shock over 200% are more likely to be purchasing an investment property.").

32. Id.

33. Id. at 8.

34. Id.

35. See Mortgage Asset Research Inst., Eighth Periodic Mortgage Fraud Case Report to Mortgage Bankers Association 11 (2006), available at http://www.marisolutions.com/resources-news/reports.asp (follow "Eighth Case Report to MBA (April 2006)" hyperlink) (identifying "the ever-present drive to speed up the mortgage approval process" and "escalating home prices in many markets" as "[t]wo exacerbating factors [that] have combined over the past few years to pressure the industry into non-traditional practices that will contribute to future fraud reports").
occupancy fraud, according to Frank McKenna, chief fraud strategist for BasePoint Analytics, "but the industry was very focused on volume." 36

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 rejecting the riskiest loan applicants, stood to lose investors to its more aggressive competitors. Many investors would have perceived the lender's claim that it was 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. 37

Unfortunately, lenders usually uncover evidence of mortgage fraud only after the borrower has defaulted and the lender or its agent has carefully examined the original loan file. 38 Lenders reserve the right to call their loans, declaring the balance immediately due and payable, and to foreclose if the borrower did not already prepay the loan. 39 Ordinarily, people who fib do not 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 cannot—or will not—make their payments, their lenders stand to lose big too. 40 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.

III. TRACT HOME BUILDERS AND CONDO DEVELOPERS HAVE FOUND VARIOUS MEANS OF DETERRING SPEC BUYERS; ALL OF THEM ARE IMPERFECT, THOUGH NOT COMPLETELY INEFFECTUAL

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. 41 Yet, no builder or developer welcomes competition from spec buyers before successfully concluding its marketing and sales effort. 42 In

38. See Sichelman, supra note 21.
39. See id.
40. See id.
41. See DOWNS, supra note 1, at 22 & exh.1-14 ("Although many homebuilders tried to avoid selling to such speculators, the shares of home and condominium sales to speculators reached amazing levels in a few hot markets.").
addition to 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. None of these moves support developers’ efforts to create viable residential communities. Spec buyers are not going to be good neighbors; they do not lavish the same tender loving care for 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 recently told the Wall Street Journal that they had underestimated the percentage of their sales to investors. Builders figured that maybe 10% of their buyers were speculators, when speculators were probably actually picking up a quarter of their inventory. Speculators routinely signed documents promising they would reside in their homes when they had no such intention.

Spec buyers also send false signals to builders and developers regarding housing demand. Tract homebuilders and condo developers try to avoid building units too far ahead of demand by first taking non-binding reservations and then entering purchase and sale agreements with potential buyers before commencing construction. 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% presold with non refundable deposits of 20%. Speculators fueled the market and then fled, abandoning their contracts as soon as prices began to level off. Of the first 500 units built, the Miami condo developer only sold thirty, and many earlier buyers filed suit for a refund of their deposits. Currently, FNMA won’t purchase a mortgage from a bank unless 70% of the units have been presold to residents rather than investors. This should make mortgage lenders more cautious about financing projects for developers who don’t institute appropriate procedures for detecting spec buyers.
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.51 Home builders report a variety of means to screen out speculators:

1. 64% reported prohibiting buyers from assigning their purchase and sale agreements or designating a nominee to take title at closing;

2. More than half insert provisions in purchase and sale agreements prohibiting sales within the first year of ownership;

3. 36% of builders reserved rights of first refusal to buy back homes sold within the first year at the builder's selling price;

4. 36% refused to allow any units to be rented within the first year after purchase;

5. 18% would not sell more than one home to buyers with the same last names;

6. 18% used a variety of other measures, including steep fees for homes resold within the first year.52

7. Some builders have reserved 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.53 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 place 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 in the public land records that limits transfers by non-owner occupants, developers put subsequent purchasers and

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52. Id.
53. Because developers seldom impose owner occupancy requirements in new housing tracts or condos, local governments require developers of affordable housing to impose such restrictions. In this way they hope to benefit future buyers of limited means, and prevent the first generation of buyers from pocketing the subsidy by selling their units to the highest bidders. See, e.g., Alfaro v. Community Housing Imp. System & Planning Ass'n, Inc., 171 Cal. App. 4th 1356, 89 Cal. Rptr. 3d 659 (Cal. App. 6th Dist. 2009), as modified on denial of reh'g, 2009 Cal. App. LEXIS 377 (Cal. App. 6th Dist. Mar. 18, 2009) and review denied, 2009 Cal. LEXIS 4875 (Cal. May 13, 2009).
mortgagees on constructive notice, potentially clouding the titles of all grantees, owner occupants and non-owner occupants alike. Before buying or financing a unit subject to a recorded restriction like this, observant purchasers and cautious lenders would demand title policies assuring them that they are not buying in contravention of the restriction. In order to write such policies, prudent title insurers would seek written, recordable evidence of compliance, probably verified by the grantor or the grantor’s successors. This could impede sales not just to spec buyers but also to owner occupants who might have no problem confirming their intentions regarding residency in a purchase and sale agreement but who might balk at accepting a deed restriction that could complicate their attempts to sell sometime in the future and possibly also deter a mortgage lender from financing their present purchase or 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. The venerable doctrine barring restraints against alienation might bar enforcement of such a restriction.

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

54. See William H. Pivar & Robert J. Bruss, California Real Estate Law 225–27 (3d ed. Update 1997) (“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.”).


56. See Kenneth M. Morgan & Tracy A. Siebold, Discouragement of Affordable Housing Development and Financing, 195 N.J.L.J. 856, 857 (2009) (describing the necessity for title companies of discovering affordable housing restrictions in title searches and requiring documentation from borrowers to ensure that the borrower complies with the restrictions). Title insurers will want to assure compliance with recorded deed restrictions because the insured lender or buyer would take title subject to those restrictions and would seek indemnity from the title insurer. See id.

57. See Joe Adams, Condo Act Requires Insurance, Fort Myers News-Press, May 25, 2006, at G1, 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.”).

58. Cf. Mullin v. Silvercreek Condo., Owner’s Ass’n, Inc., 195 S.W.3d 484, 488 (Mo. Ct. App. 2006) (interpreting restrictions in the Declaration of Condominium, which provided that “[n]othing in this [section] is intended to restrict the right of any condominium unit owner to rent or lease his . . . condominium unit from time to time”).

59. See, e.g., Villas West II Homeowners Ass’n v. McGlothin, 885 N.E.2d 1274, 1277–1280 (Ind. 2008) (involving homeowners’ association’s enforcement of a no-lease covenant in the deed of a home purchased in a planned unit development).

60. See, e.g., Kroop v. Caravelle Condo., Inc., 323 So. 2d 307, 309 (Fla. Dist. Ct. App. 1975) (affirming lower court’s determination that an amendment to the Declaration of Condominium prohibiting leasing of any unit more than once during the period of ownership was reasonable and could be applied to an owner who purchased the unit before the amendment was adopted, because the owner had purchased the unit subject to all terms of the Declaration, including the term that the Declaration could be amended in the future).
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 the terms of the restraint. 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. A forfeiture provision may 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, consists of covenants, conditions or restrictions on the ownership or use of the transferred property, enforceable by a suit for injunction or damages against the breaching owner. A 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 forfeiture restraints; some courts treat them as invalid per se, while other courts tend to grant enforcement subject to a judicial determination of reasonableness, case-by-case. The venerable doctrine baring 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

61. 61 AM. JUR. 2D Perpetuities and Restraints on Alienation § 90 (2008).
63. Id. at 963.
64. See id.
65. Id. at 963.
66. 61 AM. JUR. 2D, supra note 61, at § 90 (promissory restraints). See Dieckmeyer v. Redevelopment Agency of Huntington Beach, 24 Cal. Rptr. 3d 895, 897 (Cal. Ct. App. 2005) (holding that the equity share of the condominium, which was part of an affordable housing program, was not due upon the purchaser’s prepayment of the loan since the covenants, conditions, and restrictions recorded on the deed had not been violated).
67. 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.").
70. See Kelley v. Broadmoor Coop. Apartments, 676 A.2d 453, 458–61 (D.C. 1996) (upholding a condo association’s levy of a surcharge on the monthly association dues of any owner renting her unit, up to a maximum of 25%, where there was no evidence that the surcharge was unreasonable, subjective, or discriminatory).
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 restrictions imposed by the promoters of subsidized housing to preclude occupants from capturing the benefit of the subsidies by selling or leasing at market prices and, thereby, frustrating the purpose of making subsidized housing available to low- or moderate-income occupants for a long enough time to amortize the social investment.

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 but reserving the right to authorize occupancy controls and discouraging speculation by real estate investors.

In Flagler Federal Savings & Loan, the original recorded Declaration of Condominium prohibited owners from leasing their units without approval of the owners’ association, but the no-leasing restriction did not apply to institutional mortgagees who acquired title to the units. The plaintiff became a mortgagee of two units while the original Declaration was in effect. In 1984, the owners’ association amended the Declaration to prohibit leasing entirely. A few years later, the plaintiff acquired title to one of the units through foreclosure and the other unit by quitclaim deed in lieu of foreclosure. When the plaintiff attempted to lease the units, the owners’ association objected, prompting the plaintiff to file a declaratory judgment action. The court held that the plaintiff was bound by the no-leasing rule included in the amended Declaration, just like non-institutional mortgagee owners who acquired title prior to the amendment.

In Oceanside v. McKenna, the court upheld restrictions requiring owner occupancy and precluding owners from renting their units in a subsidized housing project where the restrictions were "clearly and directly . . . related to the stated purposes of maintaining a stabilized community of low and moderate income residents and discouraging speculation by real estate investors."
recapture title to properties sold by non-owner occupants contrary to the agreed "blackout" period on sales. Instead, developers are entitled to reserve rights of first refusal. They do not have to match the price that 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 government not only grants basic entitlements but also decides how individuals may enforce those entitlements. There are three choices, which Calabresi and Melamed characterized 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 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, have 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 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 their personal use and only incidentally as investments. Spec buyers, by contrast, are only interested in profitable resales. Restricting their alienability options should discourage their acquisitions in the first place, relieving lenders and developers from having to spend so

76. See Jacobson, supra note 42 ("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 . . . ").
77. Cf. id. (finding that the right of first refusal allowed the purchaser to sell the home back to the developer, "in most cases, at the price that was originally paid for by the purchaser").
79. See id.
80. See id.
81. See id.
82. See id.
83. Fennell, supra note 53, at 1404-05.
84. Id. at 1406.
85. Id. at 1408.
86. Id. at 1442.
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 in the way that, for instance, sales of stolen goods\(^7\) or endangered species\(^8\) are prohibited even by bona fide purchasers. Instead, probably the most effective disincentives to spec buying are the provisions in the federal tax code that greatly favor home ownership\(^9\) and deny spec buyers capital gains treatment if they sell too soon.\(^{10}\)

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 proposal of locally enacting an “anti-speculation zoning ordinance.”\(^{91}\) Enacting such legislation on a local basis makes sense because of the uneven distribution of foreclosures and spec buying “within states and within cities in each state.”\(^{92}\) 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” and “would apply to both attached and detached single-family housing.”\(^{93}\)

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87. 63C AM. JUR. 2D, supra note 61, at § 34 (“Even though [an innocent purchaser of stolen goods] 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, although 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, 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.”) (citations omitted).


89. See GERALD J. ROBINSON, FEDERAL INCOME TAXATION OF REAL ESTATE 1-1 to 1-2 (6th ed. 2007) (summarizing the tax benefits of homeownership).

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 U.S.C. § 503 (2006)] and mortgage interest [26 U.S.C. § 163(h) (2006)]. 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 U.S.C. § 121 (2006)]. 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.

Id.

90. 26 U.S.C. § 121(a) (2006) (excluding the “gain from the sale or exchange of property if, during the [five] 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 [two] years or more” from gross income).


92. DOWNS, supra note 1, at 69. See also id. at 22 exh.1-14, 68-69 & exh.3-4 to 3-5 (comparing rate of foreclosure by city, state, and county within California, respectively).

93. Pindell, supra note 91, at 546.
Should We Ban or Welcome "Spec" Home Buyers?

Professor Pindell’s proposal is preliminary and suggestive. Though he does not purport to spell out all the details, he recognizes 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. 94

However, Professor Pindell also thoughtfully acknowledges:

[E]xceptions 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.95

Professor Pindell’s outline of an anti-spec buyer ordinance leaves open “the appropriate resale limitation period [and] the appropriate punishment for violations.”96 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.97

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 Pindall 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.98

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.99 They could enlist local governments to assist with enforcement through development agreements or other means,100 in the way that private deed restrictions are enforced by local governments in Texas.101

94. Id. at 547.
95. Id. at 595.
96. Id. at 547.
97. See Story Bed & Breakfast, LLP v. Brown County Area Plan Comm’n, 789 N.E.2d 13, 21 (Ind. Ct. App. 2003) (holding that “a covenant, standing alone without having been recorded, may not be asserted against a subsequent [bona fide purchaser] who is without knowledge of the covenant’s existence”).
98. Pindell, supra note 91, at 588.
99. Id. at 588–89.
100. Id. at 589.
101. See e.g., TEX. LOC. GOV’T CODE ANN. § 212.153 (2009) (allowing municipalities to sue to enjoin or abate violations of restrictions affecting subdivisions within the municipality); 15 HOUSTON CODE §§ 10-551
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 of possibly recording notices of 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 the possibility of FBI investigations and federal prosecutions for mortgage fraud and of having their mortgages foreclosed for violating pledges of owner occupancy. The sanctions for violating a minimum holding period ordinance pale by comparison, especially since it is highly improbable that enforcement would be well-funded and effective.

While such an ordinance might not deter spec buyers, it might discourage buyers from acquiring personal residences anywhere in the enacting jurisdiction. The buyers' and mortgagees' title insurance costs would be greater, because proof would be required that they were not buying or financing into a violation. Additionally, purchasers forced to sell within the blackout period due to changing life circumstances—divorce, death, job relocation, financial stress—would need to procure an administrative exception from the local government. They could not 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 might 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 a time come 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 it would probably also have added to the stock of unsold, abandoned and foreclosed houses once the market plunged.

Inalienability rules are a bad idea if they are 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." 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

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102. 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.").

103. POSNER, supra note 37, at 89.
house prices and the job layoffs and bank insolvencies that deflation can bring.\textsuperscript{104}

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.\textsuperscript{105} Some housing markets have become virtually moribund where prices once soared and then collapsed to less than half their former levels.\textsuperscript{106} These markets are being resurrected with the help of absentee investors purchasing nearly the same ratio of homes as when house prices were peaking.\textsuperscript{107} Perhaps in tacit recognition of the important role of spec buyers in the current market, Fannie Mae and Freddie Mac now will purchase up to ten home mortgages owned by the same borrower, where previously they would have purchased no more than four.\textsuperscript{108} 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.\textsuperscript{109}

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 lift prices above production costs and make homebuilding become profitable once more.\textsuperscript{110} A seasoned California real estate broker specializing in branded real estate, resort and luxury condo sales recently remarked, "[O]ne thing is for certain, we sure miss those speculators."\textsuperscript{111} Had an ordinance been enacted in Las Vegas like the one Professor Pindell 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.

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de@\textsuperscript{\textsuperscript{Streitfeld, supra note 106 (noting that the previous property owners remained as rent-paying tenants for about a quarter of the houses that Brewer Caldwell, a property management firm in Phoenix, purchased for its clients in 2009)).}} \textsuperscript{\textsuperscript{109.}}
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