Legal Considerations for Stewardship Funding Arrangements

Binding Present and Future Landowners to Present Promises

WeConservePA

A landowner may agree to one or more funding arrangements that require the landowner or successor owners of an eased property to make one or more payments to the easement holder to support stewardship of the property. An understanding of what makes promises binding is critical for crafting arrangements that are enforceable over time.

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INTRODUCTION

A promise made by a landowner to make one or payments to support stewardship of her property is relatively easy to document and enforce. More challenging is making a promise made by the landowner enforceable against successor landowners. In either case, an understanding of what makes promises binding is critical for crafting stewardship funding arrangements that are enforceable over time.

The guide *Stewardship Funding Arrangements: : Options for Financing the Obligations of Conservation Easement Holders* provides an overview of the variety of funding arrangements that are available to landowners and easement holders to ensure that holders can meet their stewardship obligations over time. This companion publication delves into the legal matters, research and analysis that underpin the approaches taken in that guide and in the *Model Stewardship Funding Covenant with Commentary*.

Money Energizes the Easement

When landowners grant a conservation easement, they empower the easement holder to act when needed to further the conservation purposes of the grant. Money fuels the exercise of that power. Funding makes possible the property monitoring, reviews, enforcement actions, and other stewardship activities undertaken by the holder to ensure that the conservation purposes of the easement are achieved.

Adequacy Versus Affordability

To support stewardship, most land trusts collect from the landowner a single contribution at the time the conservation easement is granted. The contribution is invested with the returns used to fund the land trust's routine stewardship activities; the principal typically is left untouched except if needed to fund enforcement. From the land trust's perspective, the chief merit of this approach is the immediacy of payment, which eliminates the risk of future non-payment.

The single contribution approach brings into sharp focus the tension between the goals of adequacy for the holder and affordability for the landowner. A contribution of a size adequate to meet long-term stewardship needs, if required in a single payment at the time of easement acceptance, is not affordable for many prospective donors. Lowering the payment to an affordable level may risk adequacy and thereby jeopardize the effectiveness of the holder's easement program over the long term.

Another problem with the single contribution approach is that a calculation of future needs relies on estimating future probabilities based upon past experience. Will an allowed right of subdivision ever be exercised by the landowner? If calculating a single contribution, the holder must look to past experience with other landowners. If crafting a program for future payments, the holder can take a "wait and see" approach.

The solution to the dilemma of achieving both adequacy and affordability is to spread payments in support of stewardship over time.

Purpose and Structure of Guide

This guide explores and addresses pertinent legal issues when stewardship payments are deferred into the future.

The first section sets the general rule: promises to pay are binding only upon those (the "promisors") making the promise. An easement grantor's promise to make a payment or payments in the future is binding only on the grantor. Subsequent owners of the eased property have no duty to see that the promise is kept.

The next three sections explore three avenues that may be used separately or together to avoid the consequences of the general rule:

- Secure the promise with collateral; for example, a mortgage on the eased property;
- Structure the promise as a covenant running with the land; and
- Induce subsequent owners to take responsibility for the promise as if it was their own (called an assumption).

In this guide, the phrase "stewardship funding arrangement" describes the structure of payments agreed to by a landowner and easement holder to help the holder meet its obligation to provide stewardship to a property in furtherance of the conservation objectives of a conservation easement. A payment on account of the stewardship funding arrangement is simply called a "payment."

UNSECURED PROMISES

General Rule

A promise to pay a sum of money in the future is binding upon the promisor so long as:

- The promisor is legally competent (at least 18 years of age and able to make independent decisions);
- The promisor receives something of value (called consideration) for the promise;
- Or, if consideration is absent, a legally recognized substitute for consideration applies. For example, the person to whom the promise was given (called the promisee) has relied on the promise to the promisee's detriment.

Personal Liability

Promisors are personally liable for payment of the promised sum of money. The phrase "personal liability" means that, if the promisee commences a civil action against the promisors for non-payment of the obligation, the judgment obtained in that lawsuit may be collected from any of their then-owned assets: real property, bank accounts and the like.

Remedies

Lien and Garnishment

A money judgment resulting from a civil action creates a lien that automatically attaches to all of the then-owned real property of the promisors in the county in which the judgment is obtained. The holder of a judgment can obtain a court order (known as a garnishment) requiring employers and other persons to pay the income otherwise payable to the debtor to the holder instead until the debt is satisfied. The holder of a judgment can also obtain a court order (known as a levy) to take possession of property of the debtor, including both real and personal property, for sale at a public sale in repayment of the judgment.

No Other Persons or Assets Are Bound

These remedies for nonpayment *can be exercised only against the promisors and such assets as they may own at the time a judgment is obtained.* If, when judgment is entered, they are deceased or have no assets, the judgment may be uncollectible.

No Priority

The judgment lien takes its priority, compared to other liens and encumbrances on property, as of the date the court entered judgment for the promisee. If, for example, property owned by the promisors is worth $100,000 and, at the time judgment is entered, it is encumbered by a first mortgage securing $80,000 and a second mortgage securing $20,000, the judgment lien will attach as a third lien but there is nothing to be gained by ordering a sale to collect on it. The proceeds of a court-ordered sale will go to pay the first two liens, and nothing will remain for the third. Another priority risk for the promisee is that, if either of the two prior liens goes into default, a court-ordered sale will divest the third-priority judgment lien (in other words, will release the lien from the property so it can be sold free and clear).

Payment on Transfer

If the holder of a judgment lien does nothing but keep the lien in force by renewing it as required under applicable law, the opportunity exists to receive payment if and when the owners desire to sell and, to complete the sale, need to clear title. Even a deeply subordinated judgment lien, like the third-priority lien described above, needs to be removed to clear title on a voluntary (not court-ordered) sale.

Applied to Stewardship Funding Arrangements

Binding Promise

In addition to or instead of a stewardship contribution made at the time of the grant of conservation easement, the landowners may agree to make one or more payments in the future. The landowners are personally bound to make these payments as and when stipulated in a writing that they have signed and delivered to the holder. The written promise may be in a donation agreement, the grant of conservation easement, a promissory note, or other document. The promise is binding, even without consideration, if the holder has relied on the promise in accepting responsibility for the easement.

Remedies Are Few and Problematic

Priority

If a payment becomes past due and the promisors continue to own the eased property, the promisee may obtain a judgment lien that attaches to the eased property. However, the judgment lien will be subject to all existing mortgages on the property. The lien of the judgment will take priority over other liens and mortgages recorded after the date of the lien but will not relate back to the date of recordation of the conservation easement or promise of payment. (Discussed later under the topic "Secured Promises," the *French and Pickering v. Natale* case, which applies Pennsylvania law, held that a conservation easement does not function as a lien or a mortgage for purposes of establishing priority over intervening liens.)

Liability Ends with the Promisors

When the eased property passes into new ownership, the new owners have no responsibility either to see that debts of prior owners are paid or to honor promises for future payment made by the prior owners. A judgment lien obtained against the promisors does not attach to the eased property if the promisors no longer own it at the time judgment is entered. If neither the promisors nor their estates (if deceased) have other assets, then collection efforts may be futile. No one is liable for payment and no assets are exposed to collection.

Need for Court Action

Nonprofit organizations avoid collection actions whenever possible. The nonprofit may have a lawful claim but must be concerned about the potential for a nasty, but newsworthy, spate of allegations and counterclaims. Collecting on a promised donation, when nothing has been received in return, is especially problematic. But, if the easement holder has depended solely on the personal liability of the promisors to ensure collection, then its only recourse to collect on an unpaid promise is to commence a civil action.

A Solution

The law provides a solution to these problems: as discussed below, the grantors' promise may be secured with a voluntary lien on the eased property before payment is due.

SECURED PROMISES

Collateral Provides Assurance

A personally binding promise may be secured by granting a mortgage on real estate or a security interest in other non-real estate assets. The assets subject to a mortgage or security interest serve as collateral for the debt. A secured promise gives the promisee assurance that:

- payment will ultimately be collected; and
- the land will not be transferred without payments brought current.

Ownership at Risk

If the promised payment is past due, the collateral may be sold to satisfy the debt. This is true even if the promisors no longer own the collateral. The new collateral owners (although not personally liable for the debt) have an incentive to see that payments secured by their property are paid as and when due; otherwise, their ownership is at risk in an action to foreclose the lien.

Need for Clear Title on Transfer

Prospective purchasers are unlikely to acquire property subject to an existing mortgage or other lien securing past-due payments that are not the purchasers' responsibility. The practical consequence is that at settlement, the settlement agent most likely will collect the past-due amounts from the seller and subsequently deliver them to the promisee.

Priority

The priority of a mortgage or other lien dates from the date publicly recorded.

Judgment Lien Relates Back to Mortgage Recording

The priority of a judgment lien obtained *on a promise secured by a mortgage* dates to the recording of the mortgage, not the date judgment was entered. Thus, it will be superior in priority to after recorded mortgages and liens. (Central Pa. Sav. Ass'n v. Carpenters of Pa., Inc., 502 Pa. 17, 22, 463 A.2d 414, 417 (1983).

Judgment Lien Does Not Relate Back to Conservation Easement Recording

This super-priority may make a huge difference in collectability. In the *French and Pickering v. Natale* case, the court found that the judgment lien obtained by the land trust in a civil action against the landowner to collect over $100,000 in costs and expenses incurred in enforcing the conservation easement did not take priority over several other mortgages recorded after the conservation easement. The reason was that, although the obligation to reimburse expenses was set forth in a recorded document (the conservation easement), the recorded document did not grant a mortgage, thus the obligation to reimburse was *unsecured*. The land trust was not entitled to share in any proceeds of the bankruptcy sale of the conserved property. While this federal court decision is not binding precedent under Pennsylvania law, the advisable course of action is to use a mortgage, not a conservation easement, to secure landowner payment obligations.

Flexibility

A voluntary grant of mortgage or other security interest may be structured in any number of ways to achieve the needs and desires of the promisors and promisee.

Subordinate to Other Liens

The holder of a mortgage or other lien may subordinate its interest to other lien holders if it chooses to do so or has agreed to do so.

Amounts Secured

A mortgage identified as an "open-end mortgage" under Pennsylvania law may secure payment of an obligation that has not come into existence yet.

Applied to Stewardship Funding Arrangements

Stewardship funding arrangements may be both adequate to meet stewardship needs and affordable to landowners if all, or a part, of the appropriate funding amount is spread out over time or deferred until the occurrence of one or more future cash flow events. The easement holder loses the immediacy of payment but gains, via the mortgage or security interest, the assurance that the funding commitment made by the landowners will be honored, whether by those owners or future landowners. Here are some examples:

Deferred Payment Pending Cash Flow Events

Due on Sale

The grantors propose to fund stewardship out of proceeds of a sale of the eased property. When their promise is secured by a mortgage that becomes due and payable in full upon transfer, the purchaser will not close without assurance that the stewardship payment secured by the mortgage has been, or will be, paid in full from the proceeds of sale.

Release Payment

The grantors propose to fund stewardship out of proceeds of the sale of one or more lots permitted within the eased property. A mortgage is recorded against these lots immediately after the recordation of the grant of conservation easement. The grantors promise that the easement holder will receive 20% of the proceeds of sale but not less than $20,000 in consideration of the release of each lot from the mortgage. When the easement holder is notified that settlement is imminent, it will sign and deliver a release of the lot to the settlement agent for recordation upon delivery of the stipulated payment to the easement holder. The mortgage remains intact as to other lots until payment in full is received. Release of the mortgage has no effect on the conservation easement.

Notice of Transfer

An easement holder may or may not receive notice of transfer, whether or not required under the conservation easement. As holder of a mortgage on the eased property, it is likely to be notified of an impending transfer regardless of the amount secured.

Flexibility via Subordination

A mortgage securing stewardship payments need not restrict the ability of present or future landowners to access financing. The conservation easement must remain superior to all mortgages if a federal tax deduction is involved as well as in most other cases. In contrast, a mortgage securing stewardship payments may be recorded in a subordinate position: in other words, the conservation easement is placed in first position, the mortgage to the third party lender in second position, and the mortgage in favor of the easement holder in third position. The easement holder, as a mortgage holder, may also agree to subordinate its mortgage (but not easement) interest in the property to future liens. The subordination of the mortgage will have no effect on the priority of the conservation easement.

Satisfaction

When a stewardship funding arrangement has been paid in full, the easement holder must record a satisfaction clearing the mortgage from the public record. Satisfaction of the mortgage will have no effect on the conservation easement.

COVENANTS RUNNING WITH THE LAND

Exception to General Rule

The general rule that a promise is only binding upon the promisors does not apply if the promise qualifies as a covenant running with the land. A covenant running with the land—sometimes called “a running covenant” or “real covenant” —is a promise that is enforceable against future owners of the land even if the future owners did not make the promise, adopt the promise, or agree to honor the promise. That is an extraordinary result under the law, so it is only applied when the covenant meets certain requirements (discussed in more detail below) and is found to be fair under the circumstances in the court’s equitable jurisdiction. The law of running covenants developed over centuries as a means to balance the rights and remedies among holders of differing interests in real property in a fair but utilitarian way.

Liability Depends on Ownership

The promisors are personally liable for payments coming due, or performance required, under the covenant during their period of ownership but not for payments or performance first coming due after their period of ownership. Each subsequent owner becomes automatically liable for payment and performance of the covenant upon taking ownership. No documentation need be signed to reflect their agreement to honor the prior owner’s promise.

Remedies

A promisee’s remedies for a promisor’s failure to make payments as and when due under a running covenant are the same as any unsecured promise. The promisee must commence a civil action and obtain a judgment in order to collect from the assets of the defaulting owner. Unless the promise was secured by a mortgage, the lien of the judgment takes priority only from the date it was entered into court. It does not relate back to the date of recording of the document (the conservation easement, for example) in which the covenant was recorded.

Requirements of Running Covenants

Recording Is Necessary but Not Sufficient

To qualify as a covenant running with the land, the promise must be contained in a publicly recorded document; however, *recording alone does not elevate every promise to pay into a covenant running with the land*. Accepting ownership under and subject to a covenant requiring certain payments does not, by itself, imply an agreement to be personally liable for those payments.

Comparison Chart

As summarized in the following chart, the traditional requirements to be met for a covenant to run with the land are almost always met when using WeConservePA's *Model Grant of Conservation Easement and Declaration of Covenants* and most other easement forms. As to covenants for stewardship funding, the problematic issue is the last requirement—whether the covenant "touches and concerns" the land—which is discussed in greater detail below.

Running Covenant Requirement	**Satisfied in Conservation Easement?**
Writing sufficient to satisfy Statute of Frauds (a law requiring certain kinds of promises to be in writing)	Satisfied by the easement being in writing and signed by landowners
Intention for subsequent owners to be bound	Provided in article 8 of the *Model Grant of Conservation Easement*
Notice to subsequent owners	Satisfied by recording in public records of county in which property is located
Subsequent owner holds same ownership interest in property as donors (called vertical privity)	Always satisfied
Donors shared interest in the property with the conservation organization at time the running covenant was created (called horizontal privity)	Satisfied by grant of enforcement rights to conservation organization under article 6 of the *Model Grant of Conservation Easement*
Covenant must touch and concern the land	The restrictive covenants in articles 2-5 of the *Model Grant of Conservation Easement* satisfy this requirement. *As to promises to pay money, it depends on whether there is a connection between the required payment and the land bound by the covenant.*

Direct Relationship to Use and Enjoyment of Property?

Connecting Money with the Land

To meet the "touches and concerns" requirement, a promise to pay a sum of money must be directly related to the land bound by the covenant. The connection between land and money usually stems from some advantage accruing to landowner's use and enjoyment of his land that is connected to the payment.

For example, a landowner promises, in a recorded document, to pay $500 each year to his neighbor. After the land is transferred, the neighbor tries to collect and the new owner refuses to pay. If the neighbor can explain to the court how the payment relates to the land (for example, the money funds maintenance of a common drive), the court will enter judgment for the neighbor. Absent a rational explanation connecting the purpose of the payment to some advantage to the land bound by the covenant, the court may, and probably will, decline to enforce the promise. As discussed below, existing case law provides little guidance directly on point as to promises for stewardship funding. Thus, it is difficult to confidently predict whether a court will find that a particular stewardship payment satisfies the "touches and concerns" requirement.

Guidance from Pennsylvania Decisions

French and Pickering Case

Pennsylvania courts and federal courts applying Pennsylvania law have held, in several of the cases arising from *French and Pickering v Natale*, that the breaching landowner is personally liable for compensatory damages arising from a breach of a restrictive covenant in a conservation easement. There are no other reported cases in which enforcement of a promise to pay in a conservation easement has been sought in any Pennsylvania court of appeals.

Homeowners' Association Cases

Pennsylvania courts have supported the principle that landowners are personally liable for payment to a homeowners' association of charges reasonably related to services provided by the association to common areas. A number of appellate decisions have upheld the right of a homeowners' association to collect, as a personal liability of the beneficial users of the common areas of the development, a proportionate share of the cost of repair, maintenance, and upkeep of the common areas whether or not specifically provided for in the deed or other documentation of the association. The *Treasure Lake Homeowners' Association* case decided by the Pennsylvania Superior Court in 2003 upholds the principle that there is a duty on the part of the landowner to share in the costs of services that benefit his ownership in land. The *Treasure Lake* case also confirms that the remedies available to the beneficiary of a promise to pay a sum of money that qualifies as a covenant running with the land are not limited to remedies against the land (such as an injunction or foreclosure of a lien against the land) but also include the right to obtain a judgment for the unpaid sum against the owner collectible from the owner's assets including but not limited to the eased property.

State and Federal Regulation of Private Transfer Fees

No matter how strongly a covenant to make payments touches and concerns the land, when gauging the enforceability of a stewardship payment triggered by a transfer of the eased property (called a "private transfer fee"), it is important to take into account state law and federal regulation that may impact the enforceability as well as the marketability of property encumbered by them.

Private Transfer Fees Banned or Regulated in Many States

Thirty-eight or more states regulate private transfer fees. California's statute permits private transfer fees that are properly recorded and contain certain disclosures. Many other statutes, in contrast, set forth a broad prohibition on private transfer fees and then enumerate a variety of payments that are effectively exempt from the prohibition. Exceptions in some states include payments to homeowners associations as well as nonprofit organizations providing direct or other benefits to the encumbered property. *Exemption from regulation should not be taken to imply legislative authorization of the specific payment arrangements. It only leaves the question of validity and enforceability to otherwise applicable law.*

States regulating private transfer fees include (but may not be limited to) Alabama, Arizona, Arkansas, California, Colorado, Florida, Hawaii, Idaho, Illinois, Indiana, Kansas, Louisiana, Maine, Maryland, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Jersey, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Utah, Virginia, and Washington.

Pennsylvania's Exception for Conservation Easements

Pennsylvania's Act 8 of 2011 (House Bill 442) prohibits private transfer fees but provides an exception for conservation easements. The Act amends Title 68 (Real and Personal Property) of the Pennsylvania Consolidated Statutes. Anything defined as a private transfer fee by the Act is prohibited. The Act provides ten specific exclusions from the definition of private transfer fee. Conservation easement-related fees are one of these exclusions.

Conservation easement-related fees are not subject to the Act's general prohibition on private transfer fees payable to a "nonprofit corporation, charitable association or charitable trust" if the conservation easement was prepared in conformance with the Conservation and Preservation Easements Act or the Agricultural Area Security Law and the holder has been in existence for at least two years. The exception also applies to fees on real property included in the same development plan with the property that is subject to the conservation easement.

The fact that a private transfer fee falls within the exception for conservation easements under the Act does not mean that the Act authorizes collection of the fee from landowners who did not, themselves, promise to pay the fee. The rules pertaining to covenants running with the land continue to apply. Nevertheless, the statutory exception for conservation-related fees in the Act may help support the collectability of a fee challenged on the ground that the courts ought not enforce an arrangement that constrains free marketability of land and, thus, is contrary to public policy. The argument in support of the fee would be based upon the presumption that the General Assembly, when excepting fees related to conservation easements from the general prohibition, must have concluded that such fees were consistent with the public policy of the Commonwealth. Further, because the fee advances the goals of conservation, the exception fits squarely within the extensive body of policy statements, from all branches of the government of the Commonwealth, in support of conservation of natural, agricultural, and scenic resource. Thus, the argument would conclude, a conservation-related transfer fee furthers Pennsylvania's strong public policy in favor of conservation and outweighs the competing public policy (free marketability of land) advanced by the Act.

Regarding government-held conservation easements, the Act provides a broad exception for: "Any tax, fee, charge, assessment, fine or other amount payable to or imposed by a governmental authority."

FHFA Rule Banning Properties from Federal Mortgage Programs

The Federal Housing Finance Agency (FHFA) published its final rule in March 2012, which prohibits its regulated agencies, Fannie Mae (FNMA), Freddie Mac (FHLMC) and the Federal Home Loan Banks from purchasing mortgages on properties encumbered by certain types of private transfer fee covenants. Transfer fees that support, among other things, environmental, conservation and recreational activities are exempt if they directly benefit the property burdened with the covenant. Direct benefit also includes activities in a burdened community or adjacent or contiguous property or other property used primarily by residents of the burdened property.

Running Covenant or Not? Enforceable or Not?

Applying the guidance derived from the sources described above to a promise for stewardship funding is challenging. The examples listed below range from describing a direct, visible, on-site connection between the stewardship payment and some advantage to the land burdened by the covenant to no connection at all. There is little or no case law on point; thus, the estimations of enforceability are best guesses based upon an examination of a variety of sources including the guidance discussed above: cases discussing the history of the "touches and concerns" requirement; cases differentiating personal covenants from lease covenants that run with the land; examples included in the Restatement of the Law of Servitudes (3rd) (the "Restatement"); and cases discussing the nexus requirement for enforceability of impact fees.

The prospects for enforceability noted below each example address the issue solely from the standpoint of whether the nexus exists to support a running covenant. ***The greater the uncertainty, the greater the need to consider other avenues (secured promises and assumptions) discussed in this guide.***

A number of the examples also note the potential application of the FHFA rule to the scenario.

Resource Management

Example: Conservation easement provides that conservation organization is to furnish on-site resource management activities to high-value habitat within the conserved property in accordance with standards set forth in the conservation easement. Landowner is to reimburse reasonable cost of providing these services on a quarterly or other periodic basis.

Enforceability: Reasonable costs of maintenance are highly likely to be collectible from landowner as a running covenant. Conservation organization is providing a service to the land by keeping it in compliance with the standards of the conservation easement and, consequently, it will incur costs that would otherwise have been borne by landowner.

Reimbursement of Costs of Review

Example: Conservation easement includes a requirement to reimburse the costs and expenses reasonably incurred in connection with review of an action (e.g., subdivision, timber harvest plan) proposed by the landowner that is permitted by the easement subject to the review of the conservation organization.

Enforceability: Highly likely to be collectible as a running covenant because the services furnished in connection with the review are directly related to either the intensity of use or development of the property and were prompted by a request from landowner.

Reimbursement of Costs of Violation

Example: Conservation easement includes a requirement to reimburse the costs and expenses incurred in investigating a possible violation and exercising enforcement rights under the conservation easement.

Enforceability: If the costs arise from landowner's acts or omissions with respect to the use of the property, then there is a direct connection between the use (or misuse) of the property and the investment of time and money on the part of conservation organization. The costs are collectible as a personal liability of the defaulting landowner.

Regular Stewardship Payment

Example: The conservation easement includes a promise to make a payment of $500 per year (subject to adjustment over time to maintain currency value) to fund the costs of routine monitoring and availability for consultations with landowner on issues pertaining to conservation of property.

Enforceability: Likely enforceable as a running covenant although the court may use its discretion to adjust amount so as to be reasonably related to the benefit conferred. The benefit would be assurance to the landowner that changes (if any) from prior monitoring conform to the standards set forth in the conservation easement. Availability for consultation on resource management issues pertaining to the property is a benefit whether or not landowner chooses to utilize the benefit.

Accrued but Unpaid Balance Due on Transfer

Example: Same as above, but with the addition that, if not paid as and when due, the obligation bears interest at a stipulated fixed rate, compounded annually, and is due and payable in full by the owner (if not earlier paid) at the time of, and as a condition of, transfer. This variation reduces the number and frequency of collection actions that may need to be taken from delinquent landowners while providing an incentive for prompt payment to avoid accumulation of interest.

Enforceability: Likely enforceable as a personal liability of landowner but unlikely that court would issue an order restraining transfer unless conservation organization was paid. A court may decline to enforce a running covenant that unreasonably restrains alienation (free transferability). Other alternatives to induce compliance are discussed below such as conditioning delivery of a certification of pre-transfer inspection upon payment in full of all of the accrued but unpaid obligations of the transferring landowner.

FHFA: Many payment obligations (residential mortgage loans, for example) are due and payable in full on transfer if not earlier paid. That does not make them “transfer fees” for purposes of the FHFA rule discussed above.

Annual Payment Subject to Increase for Insurance

Example: The $500 annual payment described above is subject to increase to cover the allocated cost of the premium for conservation defense insurance (e.g., Terrafirma) applicable to the property (and the number of lots within the property).

Enforceability: More likely than not to be enforceable as a running covenant although the court will have the power to weigh in on the reasonableness of the amount. Having funds available to enforce the conservation easement through insurance coverage reduces the reimbursement obligations of the landowner upon a violation. Requiring uniform standards to fund enforcement from all landowners of conserved property spreads the burden in an equitable manner.

Payment on Transfer Based on Typical Costs

Example: The conservation easement imposes a charge of $2500 (subject to adjustment over time to maintain currency value) upon transfer of each conserved property. The amount is calculated to include the time typically spent with brokers and prospective purchasers or lenders explaining and interpreting the conservation easement as well as the time spent on a pre-transfer inspection and issuance of certification of violations (if any) prior to closing of the transfer.

Enforceability: Likely enforceable as a running covenant but with a possible risk that a court could exercise its discretion to limit the charge to the costs and time actually incurred by the conservation organization in connection with the transfer. The free transferability of the land is enhanced when the conservation organization makes itself available to educate and inform prospective purchasers and others as to the operation and effect of the conservation easement.

FHFA: The FHFA rule excludes payments that defray actual costs of transfer of the property. This reimbursement is calculated, for convenience of collection, at a fixed sum sufficient to defray the cost of services typically rendered in preparation for a transfer. Whether that difference (actual vs. typical) is material for purposes of the FHFA rule is uncertain.

Annual Payment for Benefit of Contiguous Preserve

Example: The conservation easements on buffer properties surrounding a preserve contain a provision charging a fee of $1000 per year to fund preserve maintenance because that investment significantly enhances the value of the conserved property.

Enforceability: Likely enforceable as a running covenant but enforceability would be enhanced if benefit to landowners had a more direct connection to costs of maintaining the preserve; for example, opportunities for access to the preserve not generally available to the public.

FHFA: Under the FHFA rule, the benefit to adjacent or contiguous property may support a finding of direct benefit.

Use of the payment structures discussed below may rule out the availability of future FNMA/FHLMC residential mortgage financing for the property under the FHFA Rule mentioned above.

Percentage of Proceeds: Funding for Community Services

Example: The declaration for Sand Acres, a common-interest community developed in an ecologically sensitive area, requires payment of a transfer fee of one percent on the sale of each lot to the Sand Acres Foundation, a conservation organization that holds a conservation servitude restricting development of most of the commonly held land owned by the Sand Acres Community Association. The Foundation manages the property subject to the conservation servitude and carries out environmental education programs.

Enforceability: A transfer fee that has a direct benefit to an identifiable community is likely to be found enforceable by a court because it has a rational justification. In this example, taken from the Restatement (§3.5 Comment c.), the revenues support land management and educational programs for the common interest community rather than a particular lot; nevertheless, the benefit is to common areas held for the benefit of all lot owners. This type of private transfer fee is also exempt under the FHFA rule.

Variation. Same as the *Sand Acres* example above but the conservation organization does not have any management responsibilities for the common areas of the community. The conservation organization has funded major restoration and conservation projects in and around the development, but it also uses the money to subsidize a substantial portion (30%) of its operating budget and distributes surplus funds to other non-profits in the vicinity.

Enforceability: The connection between land and money in this variation is not as clear as in the *Sand Acres* example. The connection between the funding of projects in and around the development and the conserved land can probably be established if those projects further the conservation objectives for the conserved land. A reasonable allocation of general overhead to those projects may also be rationally justified. But, without more information connecting the funding to the conserved property, it is difficult to articulate a rational explanation why a landowner ought to be compelled to contribute a portion of the value of his land to support non-profits in the vicinity. The transfer fee is only exempt if the projects funded are within the community or adjacent or contiguous lands.

Percentage of Proceeds: Revenue to Easement Holder

Example: The conservation easement imposes a fee of one (1%) percent of the value of the conserved property upon transfer of the conserved property. There is no obligation to dedicate the fee to stewardship services benefitting the property. There is no correlation between the fee and stewardship services rendered by the conservation organization for the property. Nor is there correlation between stewardship services rendered across the conservation organization's portfolio of easement holdings and amounts collected in connection with that portfolio.

Enforceability: Enforcement as a personal liability based upon a running covenant is problematic without some connection to benefits conferred on the landowner's use and enjoyment of the property such as those described in the preceding examples. There are a number of legal theories that a court might find persuasive to invalidate a covenant that does not, on its face, evidence any connection between the revenues collected and some benefit to the landowner. Besides the "touches and concerns" element, the covenant may be found to be an indirect restraint on alienation, contrary to public policy, or unconscionable. The reasoning that underlies all of these equitable defenses is that the legal system should not be used to enforce an arrangement that lacks a rational justification against an unwilling participant.

FHFA: This transfer fee would not be exempt under the FHFA rule. The result is a decrease in marketability of any residential mortgage loan made on the property. The lender's choices are to keep the loan as a long-term investment or sell to another private investor; there is no opportunity to sell the loan on the robust market conducted by FNMA or FHLMC. The result of a decrease in mortgage financing opportunities is likely to be a decrease in marketability of the property itself.

Summarizing the Examples

The enforceability as running covenants of the payment arrangements noted above can be summarized succinctly: A payment arrangement in which funds are *dedicated* to a purpose that has a *direct* connection to the *parcel of land burdened* by the covenant is more likely to be enforceable than one that does not.

ASSUMPTION OF LIABILITY

New Owners Adopt Promise of Prior Owners

A promise to pay can be collected from the person who made the promise and others who adopt the promise as their own. This is called an "assumption of liability," and it is frequently used in real estate transactions when the parties do not want to rely solely on the covenants qualifying as running covenants.

Absent Assumption

Without an assumption of liability, the successor owner has no personal liability for payment of a prior owner's debt unless the promise to pay qualifies as a running covenant.

Customary in Lease Transactions

A prospective tenant who wants to take the place of an existing tenant under an existing lease is typically required to assume personal liability for compliance with obligations arising under the lease from and after the date the lease is assigned. The obligation to pay rent in return for possession has long been held a running covenant but other affirmative obligations in the lease may not be so clear. Rather than argue later about which covenants are or are not binding on the transferee, the landlord usually demands, as a condition of permitting transfer, that the transferee adopt all of the covenants as the transferee's own.

Documentation of Assumption

Signed Writing

The agreement to assume personal liability for future payment obligations does not have to be in a separate document or a recorded document to be effective under Pennsylvania law. Any writing signed by the new owners will suffice if it evidences their intention to be legally bound to make the promised payments.

Deed Provision

Under Pennsylvania *mortgage* law a writing signed by the new owners is not required. An assumption may be implied by the inclusion of the phrase "which grantee assumes and agrees to pay" in the deed of transfer. A provision in the deed of transfer, such as the following example, may operate to bind the transferee to fulfill payment obligations in a conservation easement; however, that result is uncertain because, as discussed above, courts may or may not apply to a conservation easement rules applicable to mortgages.

> Under and subject to the grant of conservation easement dated ____ and recorded ____, which includes certain payment obligations that, by acceptance of this deed, grantees, intending to be legally bound hereby, assume and agree to pay.

To enhance enforceability, the deed should provide for joinder by grantees to acknowledge acceptance of the provision.

Assumption as an Alternative to Due on Transfer

One strategy to incentivize the transferring owners to include an assumption agreement as part of their sales transaction is to make the unpaid amount due and payable in full upon transfer *unless* the transferring owner obtains an assumption of liability for future payment from the transferee.

Example: Stewardship funding of $50,000 is needed because the property may, under the conservation easement, be subdivided into five lots. Easement grantors want to defer payment until the lots are separately owned. Easement holder is willing to divide the $50,000 into five installments of $10,000 each due on transfer of lots to third parties; but what if the property as a whole is transferred before the stewardship funding is paid?

First Alternative: Secure the Promise. The best solution for the easement holder is to secure the stewardship funding with a mortgage to be released as lots are sold. But what if the easement grantors refuse to grant a mortgage?

Second Alternative: Running Covenant. This alternative depends on the nexus between the payment and some advantage to the land. What if the easement holder is not entirely certain the promised stewardship funding will be enforceable as a running covenant?

Third Alternative: Assumption: The easement holder agrees to allow payment in installments but only if the $50,000, or remaining balance, is due upon transfer of the property or so much of it as remains after lot sales. The exception to this rule is that, if the then-owners procure from their prospective transferees a legally binding assumption of their obligation to make stewardship payments as and when due, then easement holder will waive its right to payment in full upon transfer and allow continued payment in installments as lots are separately transferred.

TAX DEDUCTIBILITY OF STEWARDSHIP PAYMENTS

A charitable contribution must be voluntary in order to be deductible for federal tax purposes.

Original Donor

Payments made by the original donor in satisfaction of a funding commitment to a conservation organization may be, but not necessarily are, deductible as charitable contributions for federal tax purposes. For further information, *see* the guide *Donation Agreements*.

Future Owner

Stewardship payments made by a subsequent owner (not the easement grantor) are not deductible as charitable contributions. Taxpayers can only deduct contributions made as a result of their own voluntary promises to donate (not someone else's promise).

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