



Affordability Preservation Project: Final Recommendations

A Product of Community Legal Resources
Affordability Preservation Project
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INTRODUCTION

Traditional approaches to providing affordable, single-family housing have primarily focused on offering subsidies to first-time homeowners. Unfortunately, these programs are only able to provide affordable housing to a limited number of people. Additionally, once the initial buyer sells the home, the subsidy is lost. The primary subsidy beneficiaries receive a windfall and, with the loss of the subsidy combined with any appreciation, the home is no longer affordable. This ability to “flip” the home, particularly in a hot housing market, has resulted in an inability to preserve affordable housing. In response to this “flipping” effect, many housing organizations have searched for other options to maintain long-term affordability.

The Affordability Preservation Project (APP) is a continuation of Community Legal Resources’ (CLR) Community Land Trust (CLT) Project which was initiated in the Fall of 2004. The CLT Project developed the legal tools necessary to create community land trusts in Michigan. A community land trust is a private, nonprofit corporation created to secure affordable access to land and housing. The CLT acquires land with the intention of maintaining ownership forever. A home built on the land can be sold to an income-qualified buyer. The CLT then leases the land to the purchaser of the home. The CLT can use the rents it collects to provide continuing support for the homeowner and the CLT’s program. Additionally, the CLT maintains an option to re-purchase the home, in the event the owner decides to sell. This dual ownership and re-purchase option allows for continued, permanent affordability of the CLT homes.

The CLT is an effective model for ensuring permanent affordable housing. However, there are other mechanisms and legal structures that are more familiar to Michigan lawyers, tax assessors, developers and homebuyers. CLR initiated the Affordability Preservation Project to assist its nonprofit clients in understanding these additional options for preserving affordable housing and determining whether they were more or less effective than the CLR model. An attorney team was empanelled in 2005 to research and assess these options according to several desired characteristics, including the following:

1. Creation of an income stream to the nonprofit sponsor that will ensure unit viability and ongoing operating revenue;
2. Accommodation of scattered-site development across multiple political

jurisdictions;

3. Encouragement of ongoing input from income-eligible owners while preventing the flipping of property to non-qualified homeowners; and
4. Simplicity of design and common understanding of the models by all parties.

A short description of each of the models studied by the APP team is as follows:

Deed Restriction

Deed restrictions are restrictions imposed on the buyer of land when property is sold. The restrictions are either included in the seller's deed to the buyer or included in a separate agreement referenced in the deed. The restrictions can vary as to subject matter. Deed restrictions that focus on affordability may require that the property will only be sold to a purchaser satisfying low-income eligible or specific affordable housing income requirements. The deed restrictions may also require that the resale price not exceed a certain amount. Deed restrictions are an attractive affordability mechanism because the restrictions can be long-term and enforced by the nonprofit. Deeds and deed restrictions are also common real estate transaction documents, which means they are familiar and easy to understand.

Condominium and Limited Equity Cooperative

Given the lack of use and common knowledge of the housing cooperative model, it was determined that this is not the best model to use to preserve affordability in Michigan. Conversely, since condominium as a form of ownership is much more commonly utilized in Michigan, in the market rate context, utilizing condominium ownership in an affordable or mixed-income development does offer a recommendable model. In a condominium, members own some aspect of the property. This ownership interest may be shares in a cooperative, which is the legal entity that owns the property, or it may be ownership of a unit in a condominium, which is ownership of an individual dwelling unit together with some part of the development in common.

The documents that govern the activities and relationship of the members present an opportunity for use of mechanisms that preserve affordability. These can include restrictive covenants or limitations on the return or profit upon sale. The documents of a condominium can include whatever restrictions the organizer of the entity wants to utilize to preserve affordability. For example, with a condominium, a restrictive covenant can be included in or amended to the recorded master deed. This covenant can limit ownership and transfer to subsequent owners of the condominium units to guarantee affordability. Given the authority of the condominium association, however, there may also need to be a Declaration of Affordability Restriction recorded prior to the Master Deed. Additionally, under the applicable statutes, restrictive covenants might be modified or removed without the consent of the nonprofit.

Statutory Affordable Housing Covenant

A statutory affordable housing covenant is an agreement that is specifically made enforceable by statute that permits a land owner or other qualified party to control the purchase price of residential property for the purpose of maintaining affordable housing. Michigan does not currently have an applicable statute, therefore, affordable housing covenants that are not linked to real property interests provide a weak legal foundation for assuring that affordability is preserved.

Mortgage and Note

Mortgages can be used as a way to maintain affordable single-family housing through restrictions in the mortgage as to eligible purchasers and as to resale prices. In addition to requiring that any subsidy be repaid if the home is sold in violation of the restrictions, the mortgage can include a provision that gives the subsidy provider the right of first purchase. The subsidy provider would then have the ability to locate another low- or moderate-income buyer for the property. Mortgages prove to be an attractive mechanism for preserving affordability because they are the traditional legal document for real estate transactions and are easy to manage. When coupled

with a promissory note to recapture a purchase money loan or subsidy for a below market sales price, this also gives the subsidy provider a revenue source.

Community Land Trust

Community Land Trusts are a vehicle for enforcing affordability mechanisms. Under the CLT model, a nonprofit organization acquires land and develops housing on the property. The organization then sells the house to a low- or moderate-income person, but leases the land under a long-term lease. The ground lease may contain provisions that guarantee the house's continued conveyance to a low- or moderate-income person, thereby preserving affordability. The CLT approach to affordability is preferable due to its ability to create a legal structure for enforcing permanent affordability, together with an income stream that can be used as a source of support to the homeowner and the nonprofit's program. Additionally, the CLT structure provides for a Board which represents the interests of all parties – homeowners, beneficiaries, and the community.

More detailed descriptions of each of the five models, in the form of white papers, are included in the Appendix.

RECOMMENDATIONS

In evaluating the alternatives to the community land trust, the APP team considered several key factors: (1) the legal enforceability of the affordability restrictions; (2) the familiarity and simplicity of the legal concepts; (3) the opportunity for the nonprofit to have an ongoing relationship with the homeowner in order to provide continuing assistance; and (4) the ability to generate an ongoing income stream to support the nonprofit's operations and homeowner assistance program.

The results of the Affordability Preservation Project reveal that the community land trust model appears to be the best option for achieving continued affordability in light of these considerations. While the CLT is a complex model, requiring an understanding of a number of legal concepts which may be unfamiliar to homebuyers, attorneys, tax assessors and others, it does achieve many of the factors described above by combining the following: (1) a strong legal basis for long-term enforcement of affordability restrictions; (2) a mechanism for continuing interaction between the nonprofit (as landlord) and the homeowner (as tenant); and (3) an ongoing income stream (through the rent).

Individually, none of the other models studied satisfied all of the factors as well as the community land trust. For example:

- ◆ A deed restriction offers one of the best alternatives for establishing enforceable restrictions, and it is a simple, familiar concept. However, a traditional deed restriction does not provide the flexibility to modify restrictions as circumstances change, and it does not provide a mechanism for generating an ongoing income stream or continuing interaction with the homeowner.
- ◆ A mortgage and note model offers a simple, familiar concept that can provide an ongoing income stream to the nonprofit and a continuing relationship with the homeowner. However, it does not provide reliable long-term enforceability of affordability restrictions. Once the mortgage debt is paid off, by statute the mortgage must be discharged. A mortgage by itself cannot assure that the affordability restrictions will be maintained.
- ◆ Condominiums are relatively common in Michigan, and the condominium structure contemplates assessing fees to provide support for unit owners. However there are practical difficulties in using a condominium for single-family scattered site homes, and, by statute, restrictions imposed in the condominium documents may be changed or removed by a 2/3 vote of the condominium unit owners and mortgagees regardless of what the documents say. Again, the APP team found no way to guarantee that the affordability restrictions would not be lifted by condominium members without the existence of some other mechanism.

In order to achieve the goal of enforceable, permanent affordability and the related goals of an ongoing income stream and a mechanism for guaranteeing ongoing involvement with the homeowner, some combination of models must be used. The products of the APP illustrate some of these combinations:

1. Sample deed with two sample related restrictions: (1) a “Declaration of Affordability Restrictions” designed to preserve affordable housing using CLT type restrictions and (2) a MSHDA “Use Agreement” for use with HOME funds (APP Exhibit 1)

In this instance, applicable affordability restrictions are included in a separate document that is to be recorded prior to the deed from the nonprofit to the first homeowner. The sample Declaration of Affordability Restrictions, which is based on the CLT lease type restriction, can be amended after the initial sale by the nonprofit. This allows for more flexibility than a traditional restriction that is included as part of the initial deed. The MSHDA Use Agreement provides another example of an affordability restriction that can be used in combination with the deed.

The initial deed from the nonprofit requires subsequent homeowners to comply with the identified restrictions and gives the nonprofit the right to repurchase the property at a specified low price if the restrictions are violated. Implementing restrictions through a right of repurchase (even with a low price) enhances the enforceability, and designating a specific price makes it simpler for both the homeowner and a court to understand what should happen if the restrictions are violated.

2. Sample mortgage and promissory note (APP Exhibit 2) to be used with a deed restriction

Use of a mortgage in combination with a deed restriction offers the advantage of a simple, familiar set of documents that achieves the goals of preserving affordability and creating an income stream for the nonprofit sponsor. The mortgage can include a provision that outlines the relevant restrictions providing an additional lawyer of enforceability. However, residential mortgages are subject to extensive State and Federal consumer regulation. A nonprofit should not use mortgages on homes until it has consulted with counsel to see whether it is practical to proceed without violating these regulations.

3. Sample condominium master deed and bylaws with affordable housing restriction (APP Exhibit 3) to be used with a deed restriction

For a project involving multiple homes (either multi-unit building or adjacent single family homes), use of a condominium in combination with separate affordability restrictions achieves affordability preservation with the added benefit of providing an opportunity for active participation by homeowners through the condominium association and a possible source of revenue through condominium fees. Restrictions can be included in the condominium documents. However, since the condominium documents can potentially be amended without the consent of the nonprofit, it is advisable to include affordability restrictions in a separate document that is recorded before the master deed.

This document is a product of the Community Legal Resources Affordability Preservation Project. Please check the CLR Affordability Preservation Project website for updates to this document:

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This publication is intended to provide general information, and is not a substitute for legal advice. If you have additional questions about this issue, contact Community Legal Resources at 313/964-4130.

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