

## AFFORDABILITY PRESERVATION PROJECT

### Community Land Trust

#### *How does the Model work?*

The community land trust (CLT) model is a vehicle for implementing one or more of the mechanisms for helping to assure affordability—for example, restrictions on resale. It is not an alternative to such affordability mechanisms; rather, it is a way of assuring they work long-term.

In the CLT model, a tax-exempt nonprofit organization (either a dedicated CLT or an existing nonprofit organization that undertakes a CLT project) acquires land by gift or purchase and develops housing on the site. The land can be either a single contiguous site or a series of noncontiguous sites. The organization then sells the housing to eligible low-income (or low- and moderate-income) persons and leases the land on which the house is built to the homeowner under a long-term ground lease.

To help assure long-term affordability, the ground lease typically contains restrictions on resale, provisions defining eligible purchasers, occupancy restrictions, provisions giving the nonprofit organization a right to repurchase the house under certain circumstances, and the like. To help assure the property retains its value, the ground lease also may contain provisions on maintenance, required insurance, and permitted improvements (or mechanisms for approving homeowner-initiated improvements). Finally, to help finance the nonprofit organization's continuing operations, the ground lease will typically include a monthly fee to be paid by the homeowner to the organization.

The main advantage of the CLT model is that it helps assure long-term affordability by providing a vehicle for enforcing whatever affordability mechanisms are used. The CLT model can also help assure that the housing is maintained properly and that both the homeowners' interests and the interests of the general public are represented. The main disadvantage is that the CLT organization must be created, funded, staffed, and maintained. The CLT approach also is new to Michigan, and its novelty—together with the complexities inherent in the division of housing ownership in a CLT—can lead to questions by lenders, local officials, and others. Finally, each CLT will have all the advantages and disadvantages of the specific affordability mechanisms it chooses to use. For example, a CLT that chooses to share appreciation with a selling homeowner will need to decide how to measure the appreciation, whether and how to divide it between the land and the house, how to deal with improvements paid for by the homeowner (and whether and how such improvements will be permitted), what formula or other mechanism to use for dividing the appreciation between the homeowner and the CLT, and so forth.

### ***Implications of the Model.***

There is no express statutory framework for CLTs under Michigan law. There also is no overall statutory framework for the affordability mechanisms the CLT can use. Accordingly, each CLT in Michigan must deal with property tax exemption and assessment issues, title issues, enforceability issues, and other state law issues presented by the model. These issues fall into two general categories: first, the issues presented by whatever affordability mechanisms are used by the CLT (restrictions on resale, purchase options, mortgage and purchase option, etc.); and second, the issues presented by the division of home ownership into two separate interests.

On the other hand, the federal tax issues presented by a CLT are relatively straightforward. Ordinarily, a stand-alone CLT will qualify for tax-exempt status under section 501(c)(3) of the Internal Revenue Code and will be able to maintain that status over its lifetime. Similarly, for an existing exempt organization, a CLT project will ordinarily be an exempt activity that has no negative implications for the organization's exempt status.

### ***Implications for Michigan property taxes.***

The implications of a CLT on Michigan property taxes are still unclear. Michigan's statutory scheme provides a basis to argue that some or all of the land owned by the CLT will qualify for a property tax exemption under Michigan law, at least until the housing on the land is sold, but probably not thereafter. Following sale, the CLT can argue that the market and taxable value of the land is diminished by being subject to the ground lease, and the homeowner can make a similar argument based on the affordability provisions of the ground lease, which should reduce the market value of the house.

### ***Impact on transferability and title.***

Because the CLT model divides the housing into two interests—the land and the house—any transfer will typically involve both a sale of the house (which should be treated as a sale of real property) and an assignment of the ground lease. As to title, the information developed during the recent CLT Project suggests that obtaining title insurance should not present significant issues.

### ***Protection of third-party interests.***

The protections afforded lenders and other third parties will largely depend on the particular affordability mechanisms used and the specific provisions of the ground lease and sale agreement. However, the information developed during the CLT project suggests no insurmountable issues for lenders on this point. In addition, the CLT model protects the interest of the general public through the typical CLT governance structure, which sets aside a certain number of Board of Director positions for interested members of the community.

### ***Implications for bankruptcy.***

During the CLT Project, the question arose whether the affordability restrictions in the ground lease could be set aside in a bankruptcy proceeding. Interestingly, a California environmental land trust filed for bankruptcy in March of this year; its managers conceded it had not properly planned for the organization's long-term operations. The court's handling of the competing claims in that proceeding may have implications for CLTs as well.

### ***Impact on third-party financing.***

The consensus that developed during the CLT Project was that use of a CLT should not adversely affect the homeowner's ability to obtain third-party financing of the home purchase. In fact, CLT Project participants developed a primer for lenders to facilitate such lending.

***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:***

***[www.clronline.org/app](http://www.clronline.org/app)***

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