

COMMUNITY LAND TRUSTS: A Primer for Financial Institutions

A Product of Community Legal Resources
Community Land Trust Project
www.clronline.org/clt

I. BACKGROUND

A. What is a Community Land Trust?

A community land trust (CLT) is a private, nonprofit corporation created to provide secure affordable access to land and housing for the benefit of the community. The CLT provides access to ownership of housing for people who would otherwise be priced out of the housing market.

CLTs are unique in that they separate ownership of land and homes. CLTs permanently own the land on which homes and other structures or facilities are built, while individuals own the home (or other structure/facility) on the land pursuant to a long-term (usually 89-year) renewable ground lease.

The CLT model does not lend itself to a “hard sell”; informed consent is essential. CLTs work to ensure that prospective homebuyers know what they are getting and what they are giving up upon purchase of a CLT home. The ground lease entered into by every CLT homeowner requires that owners live in their homes as their primary residences. CLT homeowners and their descendants have a right to occupy and use the leased land for the term of the ground lease, provided that they abide by the terms of the ground lease. In exchange for an initial subsidy from the CLT that is built into the price of the home, the terms of the ground lease place some limitations on the resale of the home—preventing resale to a household that does not qualify as low- or moderate-income, and limiting the sales price to keep it affordable. The lease lays out a “resale formula” that determines the maximum allowable price that may be charged upon resale of the home. Each CLT designs its own resale formula to give homeowners a fair return for their investment, while keeping the price affordable for other lower income people. In addition, the CLT has the right to buy each home back for an amount limited by the CLT’s resale formula.

Typically, CLTs are used in neighborhoods that are experiencing or are expected to experience gentrification. In many communities today, population growth and economic investment are driving up real estate prices so that fewer low- and moderate- income workers can afford to buy homes or rent in the communities where they work. Limited public funds are available to subsidize housing costs for lower income households. However, the gap between the amount of subsidy needed and the amount of subsidy available for affordable housing continues to widen as housing costs soar.

According to the U.S. Census, from 1990 to 2000 the median value of owner-occupied homes increased by 97% in the State of Michigan. While housing prices have escalated, government funding for affordable housing has decreased, and private funders are unable to subsidize these projects at the level previously supported by the government. While CLTs do not build equity for low-income communities as fast as conventional homeownership would, CLTs are designed to serve a population that otherwise would not have homeownership opportunities in the prevailing market. In addition, the initial investment in the affordability of the housing is preserved for future owners, thereby maximizing the utility of that investment.

CLTs are being developed in a growing number of communities – in expanding metropolitan areas from Cleveland, Ohio to Portland, Oregon; in university communities from State College, Pennsylvania, to Boulder, Colorado; and in expensive resort communities from the Florida Keys to the San Juan Islands of Washington State. In Michigan, CLTs have been formed in Traverse City, Boyne City, and Oceana County, among others.

B. No Trust Relationship

Technically it is a misnomer to call these arrangements “community land trusts” as they are organized as nonprofits and do not really embody a trust mechanism. However, in effect their corporate purpose is to maintain a “trust” over and containing affordable housing for the benefit of future owners.

C. Ground Lease Financing

Persons of low- or moderate- income seeking to purchase a home in a project that uses the “Community Land Trust” mechanism, of course, like any home buyer, can be expected to need financing. Such financing would normally be secured by mortgages on both the ground leasehold interest of the homeowner and on the improvement that is the home. Any loan to a lessee of ground leased land secured by that leasehold interest raises special considerations. In addition, the limitations on resale contained in a CLT ground lease may raise some additional special issues.

D. Community Reinvestment Act

Of course, because all CLT programs have the purpose of promoting, or at least preserving, the availability of affordable housing, federally regulated depository institutions can expect to receive CRA credit for participation in, and financial support of, these programs.

E. Liquidity

CLT-related mortgages are increasingly accepted in secondary markets. State housing agencies are often willing to purchase them, and FNMA offers a CLT program. The increasing acceptability of CLTs is demonstrated by the fact that FHA insurance is available for CLT purchase mortgages, and financing has also become available under the Rural Services 502 program. Of course, financial institutions may, instead of selling a CLT mortgage, hold it itself.

F. Role of CLT/Ground Lessor

The standard form of CLT ground lease requires that any mortgage of the ground leasehold interest must be submitted to the lessor for approval. However, it also requires the CLT/ground lessor to approve standard permitted mortgages.

II. SPECIAL CONCERNS OF LENDERS

A. Due Diligence

Because the lender's security will not consist of a fee interest in the land, but will include a lessee's leasehold interest in the land, along with a mortgage in the improvements on the land, the lender would be well advised to study the terms of the ground lease in order to gain an understanding of how its rights might be affected by limitations contained in the ground lease, including the term of the lease and provisions permitting early termination of the ground lease by the CLT/ground lessor, as well as any other provisions that conceivably could affect the value of the ground lease.

Of course, the lender will wish to receive assurance that the ground lease is valid and has been executed by parties with the legal authority to do so. Normally, the CLT will help a prospective borrower obtain title insurance for the benefit of a lender insuring the lender's lien on both the fee interest in the residential improvements and the lessee's interest in the land under the ground lease. Obviously, the lender will also wish to ensure that the remaining term of the ground lease exceeds that of the proposed loan. The lender will also wish to ensure that it will be entitled to receive notice of any possible early termination and also have the right to cure the basis for such termination. Finally, the lender will wish to ensure that any resale price restrictions in the CLT ground lease intended to maintain the availability of affordable housing do not prevent resale at a price high enough to allow the lender to resell for an amount sufficient to repay the loan.

B. Specific Issues

1. Term

If the ground lease that is security for the loan were to terminate before the maturity of the loan, the lender would find itself partially unsecured during a portion of the term of the loan. Similarly, to the extent that the lender is also secured by a mortgage on the improvements, access to the improvements would depend on the existence of the ground lease, and, if the ground lease expired before maturity of the loan, the lender would hold a mortgage on improvements without the ability to access them during the later term of the loan.

Further, in that the value of the collateral might well depend on its term, a lender would wish there to be a healthy term remaining on the ground lease long after the maturity of the loan.

2. Termination

Similarly, the value of the lender's collateral would be adversely affected were the ground lease to be terminated for any reason during the term of the loan. Normally, the CLT/ground lessor will reserve to itself in the ground lease a right to terminate, for example if the owner stops occupying the premises. In that the entire purpose of the CLT is to promote and preserve low- and moderate- income home ownership, the right of the CLT/ground lessor to terminate where the property is not being so used, is fundamental to the purpose of the CLT. Similarly, the homeowner/ground lessee's payments to the CLT/ground lessor may be key to the economic survival of the CLT/ground lessor and, thus, the ground lease may well provide for termination in the event of failure to make those payments. Normally, a CLT ground lease will provide for the CLT/ground lessor to give notice of such defaults to the lender and permit the lender to receive notice and a reasonable time to cure such defaults in order to prevent termination of its ground leasehold interest collateral.

3. Foreclosure

The standard CLT ground lease gives a CLT/ ground lessor a right to approve a “standard permitted mortgage”. Such a mortgage will typically require the lender to give notice to the CLT of the homeowner of any ground lessee/borrower’s default and then to wait 120 days before the lender takes steps to commence foreclosure so long as current payments, albeit not arrearage, are made to the lender during the 120 days. This gives the CLT an opportunity to try to help the homeowner cure the default. This, of course, benefits the lender in providing a backup party with an interest in ensuring the mortgage is performing, and, at least in this regard, a CLT mortgage may, from a lender’s perspective, be preferable to a traditional mortgage.

The standard CLT ground lease provides that a “standard permitted mortgage” will require that 30 days be given by a mortgagee to the CLT to cure a default under the mortgage. While some CLTs may not have the wherewithal to pay off a defaulted mortgage, this provision does permit the CLT time to find a buyer whose purchase funding may pay off the lender. A “permitted mortgage” will also allow the CLT to purchase a non-performing mortgage. A “standard permitted mortgage” would also have a provision requiring a foreclosing lender (or a lender taking a deed in lieu of foreclosure) to give the CLT an option to purchase the ground leasehold and improvements.

That failing, a foreclosing lender will sell the ground leasehold interest and improvements in the market, and the standard ground lease may contain terms permitting the lender under appropriate circumstances to do so free of the resale restrictions contained in the ground lease, which otherwise would limit the marketability of the collateral.

4. Ground Lease Fees

In assessing a borrower’s credit-worthiness, the lender will wish to include ground lease fees as part of a prospective borrower’s debt service burden. Lenders, therefore, will also wish to understand the ability of the CLT/ground lessor to increase ground lease fees during the term of the loan, which also may adversely affect the market value of the leasehold interest as collateral.

Because the very purpose of CLTs is to promote and preserve affordable housing, typically the amount of the ground lease fee is below market, which would suggest that the value of the homebuyer/borrower’s leasehold interest is correspondingly above market (i.e., in effect is subsidized by the CLT and not reflected in the home purchase price paid by the buyer). Professional appraisers are generally accustomed to valuing leasehold interests. In those geographic areas where that may not be the case, there are available detailed written appraisal guidelines that have been published by FHA, Rural Development, and FNMA. In that FNMA actively participates in CLT programs, it has specific appraisal guidelines for CLT leasehold interests as to which resale is restricted.

C. Involvement of CLT

Because of the special issues and opportunities for lenders interested in financing the CLT model of affordable home ownership, CLT staff will likely be available to work with lenders who are considering lending to a prospective homeowner. Lenders should not hesitate to approach the CLT in order to gain a better understanding of the specifics and discuss any particular concerns relating to the terms of the ground lease, as well as title insurance, appraisals and other aspects of the transaction.

This document is a product of the Community Legal Resources Community Land Trust Project. Please check the CLR CLT Project website for updates to this document: www.clronline.org/ct.

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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