

# The CLT Technical Manual

*Edited by Kirby White*



National Community Land Trust Network

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*2011*

# The CLT Technical Manual

## Preface

The National CLT Network is pleased to make this technical guide available to community land trust practitioners and those interested in organizing new community land trusts. *The CLT Technical Manual* is a work that has evolved during a quarter century when CLT experience itself was evolving rapidly. In its newly expanded form, the manual provides a comprehensive, practical guide for the ongoing operation of CLTs, as well as for future CLT start-ups.

The original “CLT manual” was developed by a group of attorneys and CLT pioneers brought together in the 1980s by the Institute for Community Economics (ICE). Their work was published by ICE as the *Community Land Trust Legal Manual* in 1991. Major contributors were Chuck Matthei, ICE’s Executive Director; David Abromowitz, author of the original version of the Model CLT Ground Lease, among other materials; Deborah Bell, author of the chapter on the Enforceability of the CLT’s Preemptive Right; and Chuck Collins, ICE’s Technical Assistance Director. Financial support was provided by the Massachusetts Housing Partnership.

In 2002, ICE published a new edition of the manual, revised in the light of a growing body of practical experience with CLTs. Two new chapters were added, dealing with operational rather than legal matters, increasing the total to 14 chapters. The new work was accomplished primarily by people actively engaged in providing technical assistance to CLTs, including ICE staff members Kirby White and Jeff Yegian, and Burlington Associates members John Davis, Tim McKenzie, Michael Brown, and Mary O’Hara – again in consultation with attorney David Abromowitz. Financial Support was provided by the U. S. Department of Housing and Urban Development.

By the time work began on the current manual, late in 2008, ICE had ceased to exist as an independent organization, and its intellectual property, including its rights to the *Community Land Trust Legal Manual*, had been transferred to Equity Trust, Inc., which agreed to share these rights with the National CLT Network so that the Network could undertake a further revision and expansion of the material. Financial support for the project was committed by the Lincoln Institute of Land Policy. The work entailed by this undertaking has extended through a period of more than two years.

Most of the material included in most of the chapters of the 2002 manual has been retained in the present manual, though portions have been restructured and the emphasis in some chapters has shifted. Certain chapters have been substantially expanded, and the titles of some have changed. A number of new chapters have been added (these are noted in the table of contents).

The work has drawn on the expertise of many more people – and the experience of many more CLTs – than was the case with previous manuals. At the time of the CLT Network’s 2008 annual meeting in Boston, the Editorial Committee agreed on a basic plan for the project. Subsequently, “work groups” were organized to provide input for new chapters on “CLTs and Condominiums,” “CLTs and Limited Equity Coops,” “Post-Purchase Stewardship,” and “Planning for Sustainability,” and for the thorough review and revision of the Model Lease. Each group “met” repeatedly in conference calls (the group working on the Model Lease, participated in more than a dozen calls over a period of almost a year).

The total amount of time, care and wisdom contributed by the many people involved has been huge. It is impossible to give adequate recognition to each, but those who have made significant contributions include the following.

David Abromowitz, attorney, Goulston & Storrs, Boston, MA  
Dena Al-Khatib, Partnership for New Communities, Chicago, IL  
Sandy Bishop, Lopez CLT, Lopez Island WA  
Michael Brown, Burlington Associates, St. Joseph, MN  
Julie Bruner, OPAL CLT, Eastsound, WA; Common Ground Consulting Services  
Lisa Byers, OPAL CLT, Eastsound, WA  
Connie Chavez, Sawmill CLT, Albuquerque, NM  
Barbara Corkrey, attorney, Community Economic Development Legal Aid  
Foundation of Los Angeles  
Julia Curry, Champlain Housing Trust, Burlington, VT  
John Davis, Burlington Associates, Burlington, VT  
Amy Demetrowitz, Champlain Housing Trust, Burlington, VT  
Jeff Evans, attorney, Portland, OR  
Tad Everhart, attorney, Community Development Law Center, Portland, OR  
Heather Gould, attorney, Goldfarb & Lipman, Oakland, CA  
Valerie Gwinn, attorney, Goulston & Storrs, Boston, MA  
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Emily Higgins, Champlain Housing Trust, Burlington, VT  
Staci Horwitz, City of Lakes CLT, Minneapolis, MN  
Rick Jacobus, Burlington Associates, Oakland, CA  
Jim Kelly, University of Baltimore Law School  
Rick Lewis, Bay Area CLT, Berkeley, CA  
Roger Lewis, Executive Director, National CLT Network  
Jim Libby, Legal Counsel, Vermont Housing and Conservation Board  
Erika Malone, Director of Technical Assistance, National CLT Network  
Mariam Masid, attorney, Colorado Housing and Finance Authority, Denver, CO  
Marge Misak, Community Land Trust of Greater Cleveland, Cleveland, OH  
Jim Mischler-Philbin, Northern Communities Land Trust, Duluth, MN  
Tim Radelet, attorney, Foley & Lardner, Madison, WI  
Greg Rosenberg, Academy Director, National CLT Network  
Paul Schissler, Kulshan CLT, Bellingham, WA  
Martha Taylor, attorney, Community Development Law Center, Portland, OR  
Jeff Washburn, City of Lakes CLT, Minneapolis, MN  
Jason Webb, Dudley Neighbors, Inc., Boston MA  
Christine Westfall, Community Home Trust, Chapel Hill, NC  
Ian Winters, Northern California Land Trust, Berkeley, CA

This manual is in every sense the product of a growing National Network.

--Kirby White, Editor

## THE COMMUNITY LAND TRUST TECHNICAL MANUAL

# Annotated Table of Contents

### Introduction: Historical Background

**Chapter 1: “Origins and Evolution of the Community Land Trust in the United States”** (a new introductory chapter, written by John E. Davis and published originally as the introduction to his anthology *The Community Land Trust Reader*, Lincoln Institute of Land Policy, 2010)

### Part I: Starting a CLT

**Chapter 2: “Initial Choices”** (a new chapter reviewing basic issues to be addressed in starting a CLT).

**Chapter 3: “Incorporation.”**

**Chapter 4: “CLT Bylaws Considerations”** (a new broadly framed discussion of CLT bylaws issues, presented separately from the Model Classic CLT Bylaws).

**Chapter 5-A “Model Classic CLT Bylaws.”**

**Chapter 5-B “Commentary on Model Classic CLT Bylaws.”**

**Chapter 6: “Tax Exemption.”**

**Chapter 7: “Launching Operations”** (a new chapter reviewing post-incorporation tasks and concerns for new CLTs).

### Part II: The CLT Ground Lease and Related Issues

**Chapter 8: “Implementing Restrictions on Ownership.”**

**Chapter 9: “Enforceability of the CLT’s Preemptive Right.”**

**Chapter 10: “Legal Issues Re. CLT Ownership”** (an expanded treatment of the chapter that appeared in the ICE manual as “Consequences of Separate Titles to Land and Buildings”).

**Chapter 11-A: “The 2011 CLT Network Model Ground Lease”** (a significantly revised version of the ICE Model Lease, with multiple versions of Article 10 reflecting different resale formulas and other variables).

**Chapter 11-B: “Commentary on The 2011 CLT Network Model Ground Lease.”**

**Chapter 12: “Resale Formula Design.”**

**Chapter 13: “Establishing and Collecting Fees”** (an expanded treatment of a chapter previously limited to the subject of lease fees).

**Chapter 14: “CLTs and Condominiums”** (a new chapter on a subject that is increasingly important for CLTs).

**Chapter 15-A “CLTs and Limited Equity Housing Coops, with Model CLT-Coop Lease”** (a new chapter reviewing issues for CLTs sponsoring limited equity coops, with a model lease derived from the new NCLTN single-family Model Lease).

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**Chapter 19: “Subsidy Structure”** (a new chapter dealing with a subject previously addressed in less detail within the chapter on Financing CLT Homes).

**Chapter 20: “Financing CLT Homes”**

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**Chapter 23: “Post-Purchase Stewardship”** (a new chapter reviewing the crucial responsibilities and tasks that are unique to CLT affordable homeownership programs).

**Chapter 24: “Planning for Sustainability”** (a new chapter reviewing an often neglected subject, with emphasis on what is necessary to sustain a CLT’s stewardship capacity).

### **Appendixes**

**A. Glossary** (an updated and expanded glossary of terms relevant for CLTs and their homeownership programs).

**B. CLT Definition from Housing and Community Development Act of 1992.**

**C. Sample Memorandum of Ground Lease**

**D. Sample Assignment of Purchase Option**

# Origins and Evolution of the Community Land Trust in the United States

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John Emmeus Davis  
(2010)

The community land trust (CLT), both the model and the movement, was a long time coming. The organization generally credited with being the first attempt to create a CLT, New Communities, Inc., was founded in 1969. Ten years later, only a handful of CLTs were operational in the United States, all of them in remote rural areas. Another 20 years passed before the number, variety, and dispersion of CLTs reached the point where it was fair to speak of a CLT “movement,” although the model’s proponents had been brazenly using that term since the early 1980s. Today, there are over 240 CLTs in 45 states and the District of Columbia, and the model has begun spreading to other countries.

As long as it took for the model to become a movement, it took even longer for the CLT itself to become the model we know today. New Communities, Inc., did not suddenly sprout newly green and fully formed from the red clay of southwest Georgia without antecedent. It was deeply rooted in a fertile seedbed of theoretical ideas, political movements, and social experiments that had been laid down over a span of many decades. Even after the appearance of New Communities, moreover, this fragile shoot still required years of cultivation and hybridization before it was ready for wider adoption.

When laying out the story of the model’s origins and evolution, it is convenient to group the distinguishing features of the CLT by ownership, organization, and operation—three clusters of characteristics that appeared at different times, each shaped by a different set of influences. The reality was much messier, of course, with ideas often leapfrogging the narrative boundaries between eras. History seldom unfolds as neatly in the living as it does in the telling.

## Ownership: In Land We Trust

In the history of the community land trust, ownership came first. The CLT’s unique form of tenure appeared in theory and practice long before “community” was grafted onto the model’s organizational stem and long before “trust” was given the operational

meaning it has today. The search for the model's origins must begin, therefore, with its unusual approach to the ownership of land and buildings.

A CLT structures ownership in several distinctive ways:

- Land is treated as a common heritage, not as an individual possession. Title to multiple parcels is held by a single nonprofit owner that manages these lands on behalf of a particular community, present and future.
- Land is removed permanently from the market, never resold by the nonprofit owner. Land is put to use, however, by leasing out individual parcels for the construction of housing, the production of food, the development of commercial enterprises, or the promotion of other activities that support individual livelihood or community life.
- All structural improvements are owned separately from the land, with title to these buildings held by individual homeowners, business owners, housing cooperatives, or the owners of any other buildings located on leased land.
- A ground lease lasting many years gives the owners of these structural improvements the exclusive use of the land beneath their buildings, securing their individual interests while protecting the interests of the larger community.

This is hardly the way real estate is typically owned and managed in the United States. Instead of seeing land as part of a shared human heritage that should be shepherded and used for the common good, land is typically treated as individual property, chopped up into parcels that are bought and sold to the highest bidder. It is deemed to be our god-given right to accumulate as much of it as we can. If we're lucky and shrewd, we can beat everybody to prime parcels that are most likely to rise in value as a town expands, as a school is built, as a factory is sited, as a road or subway is extended. So rampant, so accepted, so deeply embedded in our national culture has been this notion of the individual's inalienable right to gather to himself all the land he can grab, enriching himself in the process, that Thorstein Veblen, a nineteenth-century economist, suggested that speculation, not baseball, should be seen as our true national pastime. He dubbed land speculation the "Great American Game."<sup>1</sup>

Side by side with this ethic of speculation, however, there has persisted another tradition in the United States—less obvious, less dominant, but just as old. This is an ethic of stewardship, in which land is treated as a common heritage: encouraging ownership only by those who are willing to live on the land and to use the land, not accumulating more than they need; emphasizing right use and smart development; capturing socially created gains in the value of land for the common good. This tradition of stewardship is precolonial, extending back to Native American attitudes and the New England custom of the town commons. It also survived in the thinking of people like Thomas Paine, Thomas Jefferson, and Abraham Lincoln.<sup>2</sup>

The American writer and politician who took this alternative conception of land the farthest was Henry George. Since the intellectual origins of the CLT begin with

George, it is useful to linger here a moment, heeding his condemnation of the ethic and evils of speculation.

### The Georgist Critique

During his lifetime, Henry George was one of the most popular and influential public figures in the United States. He was also well known outside the United States. The only living Americans more famous than George in the rest of world at the time were Mark Twain and Thomas Edison, especially in those countries once parochially known as the “English-speaking world.” But fame can be fleeting, especially for someone like George, who proposed to change radically the rules of the Great American Game. Not many people have even heard of Henry George today.

His was a classic rags-to-riches American success story. Born in Philadelphia in 1839, George went to work as an office boy at 13 years of age and ran away to sea at the age of 16. He eventually landed in San Francisco, where he found employment at a local newspaper. He worked his way up from printer to reporter, to editor, and, eventually, to becoming the newspaper’s owner. He was entirely self educated. Reading widely, he encountered the work of the English political theorist John Stuart Mill. He was taken, in particular, with Mill’s concept of the “social increment,” an economic theory that asserts that most of the appreciating value of land is created not by the investment or labor of individual landowners, but by the growth and development of the surrounding society.

George asked himself a provocative question: Why is there immense poverty amid so much wealth, poverty that occurs despite social and technological progress? The answer he proposed, in a book published in 1879, entitled *Progress and Poverty*, was very different from the one provided by Karl Marx, who had wrestled with a similar question in *Das Kapital*, published 12 years earlier. Marx’s answer had been that poverty of the masses is caused by ownership of the means of production by a small cadre of capitalists who are able to capture for themselves most of the value created by labor. George, by contrast, saw poverty as resulting from the ownership of land by a small cadre of landowners who are able to capture for themselves the appreciating value of land—i.e., real estate values that are created, as John Stuart Mill suggested, by the growth and development of society.

Landlords, in George’s eyes, are little more than parasites, feeding off the productivity of others. Whenever there is economic progress—new technologies, higher wages, higher profits—landowners simply raise their rents or the selling price of their real estate holdings. This is, in George’s words, “an invisible tax on enterprise,” collected by those who contribute nothing themselves to increased productivity. Landlordism is a bane for capital and labor alike.

An obvious remedy for this sorry state of affairs would be for government to nationalize the land. But George was too much of a political realist—and too much an admirer of the Jeffersonian ideal of small-scale landholding—to propose such a radical solution. Instead, he proposed a single tax: Have government tax away the social

increment, collecting for the benefit of the larger public all of the land gains that society itself has created. By George's calculation, this tax on the appreciating value of land would be sufficient to cover all of a government's costs of providing infrastructure, schools, and other public services. This would allow the elimination of all other taxes on profits, wages, and structural improvements. A single tax would do it all.<sup>3</sup>

*Progress and Poverty* sold over three million copies during George's lifetime, an astronomical figure for his day. It was followed by a steady stream of books and pamphlets in which George repeated and refined the ideas introduced in his 1879 book. His published works and public speeches brought him wide fame and a large following, spawning an international "single-tax movement." Single-tax clubs sprang up across the United States and throughout Europe, dedicated to promoting George's ideas.

George's fame was spread abroad not only through the publication and translation of *Progress and Poverty* and other works, but also by the presence of George himself. He made six trips outside the United States between 1881 and 1890. On his first trip across the Atlantic, soon after disembarking in Ireland, he made an inflammatory speech about land reform and was thrown into jail. This turned out to be wonderful publicity for his next stop, which was London. He filled lecture halls. George Bernard Shaw was among the London notables attending an early lecture by Henry George, and he became an instant convert. So did a quiet young man named Ebenezer Howard, who was to propose a new solution for the Georgist critique.

### **Planned Communities on Leased Land**

Like George, Ebenezer Howard had little formal schooling. Instead of running away to sea, Howard had pursued an equally audacious adventure. At the age of 21, he had sailed from England to America with two friends, planning to become a homesteader in Nebraska. He soon discovered that he had no talent for farming, however, and moved to Chicago. He spent five years there, earning his living as a court reporter. He was also employed on occasion as a newspaper reporter.

Howard returned to England in 1876 and joined a firm producing parliamentary reports. This was bread labor, however. His real work, his true vocation, was studying and thinking about the dreadful condition of England's cities. Like George, he was a self learner, reading everything he could find. One of the books that made the greatest impression on him was *Progress and Poverty*, an influence that was reinforced when he heard George lecture in London.

In 1898, Howard published *To-Morrow: A Peaceful Path to Real Reform*, a book that was later reissued and retitled *Garden Cities of To-Morrow*.<sup>4</sup> The sweeping solution that Howard proposed for the crowding and chaos of urban areas was the creation of planned communities of 32,000 people ringing major cities and combining the best features of town and country. Inspired by George, he proposed that these Garden Cities be developed on land that was leased from a municipal corporation, where "men of probity" would serve as the "trustees" for this municipally owned land. Like

George, he wanted to capture the social increment for public improvement, not private enrichment. Unlike George, his mechanism was not the single tax but municipal ownership. Eventually, 32 Garden Cities were developed in England, starting with Letchworth in 1903 and Welwyn in 1909.

Meanwhile, back in the United States, other followers of Henry George were busy developing Garden Cities of their own. Structured similarly to Letchworth and Welwyn, these so-called single-tax colonies were based on community ownership of the land and individual ownership of the improvements. Two of the earliest of these colonies were created in Arden, Delaware, and Fairhope, Alabama on the Gulf Coast. Founded in the early 1900s, these leased-land communities have survived to today.

A whole new crop of intentional communities sprang up in the 1930s and 1940s, inspired by another follower of Henry George, Ralph Borsodi. It was Borsodi who first described these leased-land communities as “land trusts.” Borsodi was born in 1886, the son of a New York City publisher who was an ardent follower of Henry George. Borsodi was home-schooled by his father, an education supplemented by his own extensive readings. He never attended college, although the University of New Hampshire later awarded him an honorary doctorate, recognizing the accomplishments of a self-educated social theorist who produced 13 books and 10 research studies during a long, productive life. In 1928, Borsodi published his first book, in which he decried land speculation and landlordism along lines similar to George’s. He went further than George, however, in saying that land should never be individually owned. Only structural improvements should be treated as property. Land should be treated as a “trust.” Indeed, throughout his varied career as a writer, teacher, homesteader, and social philosopher, Borsodi insisted on calling land “trusterty,” not property.<sup>5</sup>

In 1936, amid the Great Depression, Borsodi moved to Suffern, New York, 36 miles north of New York City, and founded a community that he named the School of Living. Eventually, 30 families settled there, occupying separate homesteads around a folk school where workshops on adult education, gardening, and home production were held on a continual basis. Borsodi initiated a group title for the land, with individual homesteaders paying an annual lease fee for the use of their parcels.

Borsodi’s writings and the example of the School of Living inspired a number of other experiments in community landholding. For the next 10 years, a steady stream of educators, authors, and back-to-the-landers beat a well-worn path to Suffern to learn about rural homesteading and land leasing.<sup>6</sup> One of the most successful of the leased-land communities modeled on Borsodi’s blueprint was Bryn Gweled, started by a group of Quakers in 1940 after visiting the School of Living.<sup>7</sup> This “intentionally diverse community,” as it describes itself today, was located on a 240-acre tract a few miles outside of Philadelphia. Ownership of the land was vested in a nonprofit corporation. Over 80 leaseholds were plotted, on which families could build houses, to which they held individual title. Bryn Gweled’s ground lease was later included in the first book about community land trusts, published in 1972.

Two other influential experiments in community landholding were established during the period before World War II, one in Tennessee and the other in North Carolina. Arthur E. Morgan was the godfather of both. Morgan was born in 1878 near Cincinnati, but his family moved soon after his birth to St. Cloud, Minnesota, where Morgan was raised. His father was a self-taught engineer. Upon graduating from high school, Morgan found employment cutting timber in Colorado. Later, while working in a series of Colorado mines, he developed an interest in hydraulic engineering. Returning to Minnesota in 1900 to work with his father, he learned engineering from the ground up. He developed a special interest in dams and eventually traveled to Europe to investigate dam construction techniques on the other side of the Atlantic. He was in England soon after the first Garden City was founded, at Letchworth. He may have encountered Howard's ideas during this trip; there is no way of knowing for sure. Morgan never acknowledged his intellectual debt to Howard, even though many of the latter's proposals for the municipal ownership of land, cooperative ownership of community enterprises, and the development of planned communities through individual leaseholds were later incorporated into both of the leased-land communities that Morgan initiated in the 1930s.

In 1913, Morgan was hired by Dayton, Ohio, to build five dams after a flood had devastated the city. Winning local fame as a man of action and ideas who was also an able administrator, he came to the attention of Antioch College, a dying institution located 18 miles east of Dayton.<sup>8</sup> Elected to the board of trustees, he was later appointed president of the college. During his 15-year presidency, Morgan instituted what came to be famously known as the Antioch Plan, according to which the college's students were required to do four hours of local work for every four hours spent in the classroom.<sup>9</sup> He also published numerous articles about progressive education, community development, and new towns in popular periodicals like *The Atlantic Monthly*.

Morgan came to the attention of President Franklin Roosevelt, who was looking for someone to lead the newly created Tennessee Valley Authority (TVA). In 1933, he was appointed by Roosevelt as one of TVA's three cochairmen, but his tenure in that position was stormy and short-lived. After three years, he was dismissed by FDR. While still at the helm of TVA, however, Morgan seized the opportunity to realize his vision of the ideal community. He oversaw the construction of Norris, Tennessee, a planned community to house the workers who were building TVA's first dam, to control flooding and generate electricity. The land at Norris was owned by TVA and leased for residential and commercial development. No worker paid more than 25 percent of his salary for housing. The town's businesses were operated as nonprofit cooperatives located on land that was leased from TVA.<sup>10</sup>

Soon after his tenure at TVA, Morgan made a second effort to establish a planned community on leased land. He had been approached by a wealthy textile manufacturer from Chicago who offered to bankroll one or more of Morgan's utopian ideas for social improvement. In 1938, Morgan sent his son, Griscom, to western North

Carolina to look for land. Using money from the Chicago donor, he was able to purchase 1,200 acres in a mountain valley about 40 miles north of Asheville. Recruiting several other “men of probity,” as Ebenezer Howard had called them, to serve on the board of directors, Morgan formed a nonprofit corporation to develop a leased-land community that he named Celo. In addition to houses and farming and a few cooperative enterprises, Celo developed a boarding school based on Morgan’s ideas of progressive education. Both the community and the school exist today, still organized along lines laid down by Morgan 70 years ago.

Outside of the United States, land leasing gained a significant foothold in another country during the first half of the twentieth century.<sup>11</sup> Inspired by the theories of Henry George, the Jewish National Fund (JNF) began acquiring land in Palestine in 1901. The JNF executed 99-year leases for the use of its land. Its principal beneficiaries were cooperative agricultural communities, *kibbutzim* and *moshim*, developed on lands that were leased from the JNF. In 1967, when civil rights activists in the American South began exploring options for creating the first CLT in the United States, they looked to these agricultural communities for practical lessons, traveling to Israel to learn more about the mechanics of mixed ownership and long-term land leasing.

### Organization: Putting the “C” in CLT

In all of these leasehold communities, including the Garden Cities in England, the single-tax communities in the United States, the agricultural cooperatives in Palestine, and the intentional communities at the School of Living and Bryn Gweled, there was common ownership of land, individual ownership of the buildings, and a long-term ground lease tying the interests of the parties together. These were planned communities on leased land. They were land trusts. They were not *community* land trusts, however, as that term is understood today.

Bryn Gweled was typical in this regard. All of the houses at Bryn Gweled were located on land that was leased from a nonprofit corporation. The nonprofit was governed by homeowners living on the corporation’s land, but no one living outside of the community had a voice in running Bryn Gweled. There was neither a larger membership nor outside directors. It was an intentional community, an enclave of like-minded people. It was not a “community land trust,” lacking as it did (and still does) most of the organizational and operational elements that define the contemporary CLT.<sup>12</sup>

What are the organizational characteristics that allow us to call a leased-land arrangement a community land trust? There are three:

- The landowner is a private, nonprofit corporation with a corporate membership that is open to anyone living within the CLT’s geographically defined “community.”<sup>13</sup>

- A majority of the governing board is elected by the CLT's membership.
- There is a balance of interests on the governing board, where seats are allocated equally among directors representing the CLT's leaseholders, directors representing residents from the CLT's service area who are not CLT leaseholders, and directors representing the public interest.

The person most responsible for putting the "C" in CLT was Bob Swann. It was Swann, working in partnership with Slater King, a cousin of Martin Luther King Jr., who was to modify the model pioneered by Ralph Borsodi and Arthur Morgan, adding organizational components that eventually made community a defining feature of the CLT. What the models of Borsodi and Morgan had lacked, according to Swann, was "broad participation by the town or community." Swann supplied this missing piece. In his words, "The practice I added was open membership in the corporation bylaws to all people living in the region. This was my major contribution."<sup>14</sup> This was, in truth, not his only contribution to the model's evolution, but it was the only one he ever claimed for himself.

### Education of a CLT Pioneer

As a young man, Swann came under the influence of Bayard Rustin, then serving as youth secretary for the Fellowship of Reconciliation. Guided by Rustin and inspired by the published writings and personal example of Mahatma Gandhi, Swann made a fateful decision while an undergraduate at the University of Ohio. He would resist induction into the armed forces. This was just before America's entry into World War II. He was sentenced to five years in prison and, in 1942, entered the federal penitentiary in Ashland, Kentucky. He was soon joined there by his mentor, Bayard Rustin, along with 40 other conscientious objectors.<sup>15</sup>

As Susan Witt, Swann's second wife, was later to say in Swann's obituary, prison was Bob's "university and his monastery."<sup>16</sup> He was introduced there to many of the ideas that shaped the rest of his life. He was exposed for the first time to the writings of Lewis Mumford, Jane Jacobs, and Ralph Borsodi. All proved influential in his later thinking. But the book that impressed him the most he discovered in a correspondence course on community development that he and the other conscientious objectors took while serving out their time in the Ashland penitentiary. The book was *The Small Community*. It had been written by Arthur E. Morgan, the same man who had designed the course.

After leaving the Tennessee Valley Authority, Morgan had returned to Yellow Springs, Ohio. Two years later, in 1940, he founded Community Service, Inc., (CSI) as a vehicle for spreading his ideas about community development and small-scale, locally controlled enterprises. Among many other initiatives, CSI developed the correspondence course on the small community that reached Swann in prison. Beginning in 1943, CSI also published a nationally distributed newsletter that was mostly

a showcase for Morgan's essays and experiments promoting small-scale community enterprise. It later featured many articles about CLTs.<sup>17</sup>

Swann was so impressed by Morgan's ideas that he wrote to him while still in prison, asking for work. Morgan offered him a job with Community Service, Inc. Released from Asheville in 1944, Swann moved his family to Yellow Springs. His wife, Marjorie Swann, a civil rights activist who had been actively involved with the Congress of Racial Equality (CORE) in Chicago, also found work at CSI. Soon after their move to Yellow Springs, she resumed her involvement with civil rights.

Bob Swann quickly realized that the job promised by Morgan was office work, which he was not interested in doing. He resigned from CSI and began building houses, the start of many years earning his living as an itinerant carpenter and house designer. After only a year in Yellow Springs, he and Marjorie moved with their three daughters to Kalamazoo and then to Chicago. This was followed by yet another move to the Philadelphia area, where Bob was employed by Stanley Millgram, building houses in racially integrated communities. During this period, the Swann family resided near Bryn Gweled and had several friends who lived there.<sup>18</sup>

In 1960, the family finally settled in Voluntown, Connecticut, where Swann and his wife worked full time as leaders and organizers for the Committee on Nonviolent Action (CNVA). They focused in the beginning on issues of war and peace: organizing teach-ins, marches, and direct action protesting the arms race with Russia, the quarantine of Cuba, and the escalating war in Vietnam. They were also drawn into doing support work for the southern civil rights movement.

### **The Southern Crucible**

Bob Swann went south for the first time in 1963 to help rebuild black churches that had been firebombed by southern racists. His carpentry skills, honed over many years of building, designing, and supervising the construction of houses, large and small, were put to good use. He was to earn credibility and make connections among African American activists in the southern civil rights movement, not by making speeches but by pounding nails.

Soon after coming south, Swann was introduced to Slater King. Out of their partnership was to emerge the prototype for a new model of land tenure, known today as the community land trust. There were other influences on Swann's conception of the CLT, as well, including his previous exposure to the leased-land experiments at Bryn Gweled and Celo, his developing interest in the Gramdan Movement in India, and his close relationship with Ralph Borsodi and Clarence Jordan, the founder of Koinonia Farm. None of these influences did as much to affect Swann's thinking about the place of community in alternative institutions of property, however, as his association with the southern civil rights movement in general and with Slater King in particular.

Slater King was the owner of a successful real estate and insurance brokerage firm in Albany, Georgia. His brother, C. B. King, was a local attorney. Like their cousin,

Martin Luther King, both brothers were deeply involved in the civil rights struggle. They had helped to found the Albany Movement in 1961. Slater had served as the organization's first vice president and was elected its president one year later.

The Albany Movement was the first mass movement in the modern civil rights era to have as its goal the desegregation of an entire community. The white city council of Albany vowed that would never happen. Repeated attempts by the city's African American community to desegregate the bus station, the library, city parks, and other public facilities were stubbornly resisted. This was sometimes done quietly: The public library was closed rather than allow blacks to check out books; nets were cut off the tennis courts in the public parks rather than allow integrated teams to play. More often, the white establishment's resistance was strident and brutal. Protest marches organized by the Albany Movement resulted in mass jailings. On the orders of the city council, the police force of Sheriff Laurie Pritchard arrested every protester in sight, including Martin Luther King and Ralph Abernathy, who had been invited to town by MLK's cousins. Both men were jailed there three times in 1961 and 1962, along with more than a thousand other African Americans. When Albany's jails overflowed, hundreds of the protesters were sent to jails in the surrounding counties, where racist rural deputies were more likely to abuse black inmates. Slater King's own wife, Marion, was slapped, knocked to the ground, and kicked in the stomach by two policemen when she brought food and supplies to civil rights protesters in the Mitchell County jail. She was six months pregnant at the time. She lost the child.<sup>19</sup>

Martin Luther King came to consider the Albany Movement a failure because segregation had not been overturned by the time he moved on to Birmingham at the end of 1962. Albany's African American leaders disagreed. The Albany Movement, under Slater King's leadership, continued its efforts to register black voters and to integrate public schools. The Student Nonviolent Coordinating Committee (SNCC) and the Southwest Georgia Project, under the leadership of Charles Sherrod, continued to organize protest actions in Albany and in nearby Americus and Moultrie.

Slater King and Bob Swann met by accident. Before coming south in 1963, Swann had helped to organize the Quebec-Washington-Guantanamo Walk for Peace. This 1,000-mile peace march reached Georgia at the same time that Swann was in Mississippi rebuilding one of the state's firebombed churches. As the peace march moved farther south, feeder walks swelled its ranks, adding civil rights concerns to the march's original antiwar focus. When the march reached Albany, the city council refused to allow the integrated group to march on the main street. On their second attempt to walk through the downtown, Bradford Lyttle, Barbara Deming, and 20 other protesters were arrested by Sheriff Pritchard, the old nemesis of the Albany Movement. The protesters stayed in jail for nearly two months.

Bob Swann traveled to Albany during this period to organize support for his jailed friends. Since the Albany jail now held demonstrators from the Quebec-Washington-Guantanamo Walk for Peace, as well as local civil rights activists from southwest Georgia who had joined the march en route, Swann went to see C. B. King, the

town's most experienced civil rights attorney, to ask what might be done to help the activists who were languishing in jail.<sup>20</sup> Soon after that meeting, Swann was introduced to King's brother, Slater.

Aside from a mutual desire to get their associates out of jail, Slater King and Bob Swann discovered they had much in common. Both men had spent several years organizing nonviolent protests, Swann as a peace activist, King as a civil rights activist. By the time of their initial meeting in 1964, both had begun to shift the focus of their thinking and activism, asking themselves, "What comes next?" Both were looking for ways to move beyond the "protest movement" to what Gandhi had called the "constructive movement." They had both reached the point in their lives where they were grappling with questions like "how are the gains of struggle to be secured? how is a new society to be built within the shell of the old?"

A meeting of minds was not the only basis for the unlikely alliance that was quickly forged between this white pacifist from the far North and this black civil rights activist from the Deep South, for this was not the first time that the paths of the Swann and King families had intersected. Twenty years before, while living in Yellow Springs, Swann's wife had been actively involved with a local affiliate of CORE. Marjorie Swann had befriended another civil rights activist, an Antioch student who was majoring in music and education. The two women became lifelong friends. On occasion, when the Swanns wanted a night off, they hired Marjorie's young friend as a babysitter for their three daughters. The babysitter's name was Coretta Scott. She later married a young reverend from Atlanta whose zeal for the civil rights struggle matched her own: Martin Luther King Jr.

### **A Vision of Constructive Change: Koinonia and Gramdan**

As Bob Swann and Slater King were beginning what became a five-year conversation about land reform and economic self-sufficiency for African Americans, there was a place only 30 miles from Albany where a "constructive" program was already underway: Koinonia Farm. Founded in 1942 by Clarence Jordan, Koinonia was one of the few communities in the Deep South where black families and white families were actively living, working, and praying together, modeling the integrated society they wanted to see. Because of the racial mixing at Koinonia and because of Jordan's publicly declared views on racial equality, he and Koinonia's other residents had been excommunicated from the Rehoboth Baptist Church in 1950. Six years later, when Koinonia established an interracial summer camp, racist storeowners, wholesalers, and processors refused to do business with Koinonia and began boycotting Koinonia's agricultural products. This boycott continued into the late 1960s. The Ku Klux Klan pursued a more violent path, firing guns into Koinonia's buildings and threatening increased violence unless Jordan agreed to sell the farm. He refused.

Bob and Marjorie Swann visited Koinonia a number of times between 1964 and 1967. Dorothy Day, Wally and Juanita Nelson, and other noted American pacifists and civil rights activists were frequent visitors, as well. After personally witnessing the

sustained economic pressure and scattered violence the community was forced to endure, several of these visitors established Friends of Koinonia. This national support network raised money for Koinonia and organized the sale of the farm's pecans and other agricultural products outside of the South in the face of the ongoing boycott by local businesses. Bob Swann served as the national chairman of Friends of Koinonia until 1968.

Koinonia provided Swann with a compelling vision of a cooperative agricultural community that was created, in part, to promote economic self-sufficiency for lower-income people, a community supported by a larger network of sympathizers and supporters. Koinonia was clearly a source of inspiration for New Communities, as Swann and Slater King began laying plans for an agricultural community on leased land. Incidentally, during one of his visits to Koinonia, Swann was apparently on hand when Clarence Jordan and Millard Fuller began discussing the possibility of creating a self-help housing program for low-income people.<sup>21</sup> Koinonia Partners was founded by Fuller as a separate nonprofit to undertake this project, an organization that eventually evolved into Habitat for Humanity.<sup>22</sup>

Swann formed another important partnership during this period. In 1966, a mutual friend introduced him to Ralph Borsodi, who had just returned to the United States after four years abroad, teaching economics in India. Swann was familiar with Borsodi's writings, which he had read in prison, and he had often visited Bryn Gweled, the leased-land community inspired by Borsodi's School of Living. When Swann and Borsodi finally met, they formed an immediate attachment.

One of the things they had in common was a keen interest in the work of Vinoba Bhave, who was doing something similar to what Borsodi had tried to achieve at the School of Living and that Swann had seen in practice at Bryn Gweled. But Vinoba Bhave was doing it on a massive scale and adding organizational elements that had been missing in Borsodi's model.

After Gandhi was assassinated in 1948, political leadership of his movement fell to Jawaharlal Nehru. Spiritual leadership fell to Vinoba Bhave. Gandhi's "constructive program" had envisioned a decentralized society based on autonomous, self-reliant villages. His concept of "trusteeship" asserted that land and other assets should be held in trust for the poor. Vinoba Bhave inherited Gandhi's concern for the plight of the rural poor, especially the so-called untouchables. He began walking across India, asking rich landowners to donate a portion of their land to the poor. To his surprise, hundreds of landowners generously responded. The "Land Gift" movement—the Boodan Movement—was born. At its height, Bhave and his followers were collecting 1,000–3,000 acres a day. By 1954, 3 million acres had been distributed to the poor, and Bhave was being hailed as the "Walking Saint of India."

But poor peasants had a hard time hanging on to the small plots they were given. Much of their land was quickly lost to moneylenders and speculators. Seeing this, Vinoba Bhave transformed the Land Gift program into a "Village Gift" program; the *Boodan* Movement became the *Gramdan* Movement. Bhave now insisted that any

gifts of land must be donated to entire villages, not to impoverished individuals. The land would be held in trust by a village council—and leased—to local farmers.

By the time Borsodi left India, more than 160,000 Gramdan villages had been established. He was enormously impressed by these local experiments in land reform, discovering in the Gramdan Movement an affirmation and an audience for his own ideas about rebuilding rural economies on the basis of self-sufficient villages on leased land. Returning to the United States, Borsodi settled in Exeter, New Hampshire, and in 1967 formed a new organization to provide training and technical assistance for people who were interested in promoting rural development along the lines he had witnessed and supported in India. The name of this new organization was the International Independence Institute. Borsodi became chairman of the board and executive director. Bob Swann, who continued living at Voluntown after meeting Borsodi, was named the Institute's field director. Erick Hansch, a friend of Borsodi's from Portland, Oregon, was named assistant field director for Latin America.

In October of that same year, Borsodi and Swann traveled together to Luxembourg and London. In Luxembourg they incorporated yet another organization to complement the work of the Exeter-based International Independence Institute. According to its charter, the purpose of this new organization, named the International Foundation for Independence, was "to promote a world-wide social reformation to be based upon the theory that priority must be given . . . to the development of agriculture, local arts, local crafts, local enterprises, and local industries, and that the development of these basic social institutions should not be sacrificed to promote urbanism and industrialism." In Borsodi's expansive vision, the foundation would raise capital by issuing "notes and other instruments of indebtedness" and then loan these funds on reasonable terms to agricultural projects and rural villages in India, Latin America, and undeveloped regions in the United States, like the rural South.

Over the next 20 years, the International Independence Institute regularly changed its location and, eventually, its name. In 1971 it moved its corporate offices from Exeter, New Hampshire, to Ashby, Massachusetts. The next year, it moved again to Cambridge, Massachusetts, and changed its name to the Institute for Community Economics (ICE).<sup>23</sup>

### **New Communities, Inc.**

Even as he was helping Ralph Borsodi to establish the institute in Exeter and the foundation in Luxembourg, Swann had kept in touch with Slater King. If the leased-land model that Borsodi had pioneered in 1936 could be combined with the sort of village trusts that had been developed on such a large scale in India, Swann and King believed they might have the makings of a land reform program capable of easing the residential and economic plight of African Americans living in the rural South.

Slater King had been talking to the National Sharecroppers Fund about buying land for black farmers being forced off the land, due to either the mechanization of agriculture or retaliation for their involvement in the civil rights movement. The executive

director of this advocacy organization was Faye Bennett. She was a seasoned veteran of many struggles for social justice in the South and a personal friend of Eleanor Roosevelt.<sup>24</sup> Bennett was intrigued by the idea of creating leased-land agricultural cooperatives for black farmers. The National Sharecroppers Fund came up with the money to send a delegation to Israel to learn more about the kibbutz and moshav models of agricultural communities, both of which had been developed on lands that were leased from the Jewish National Fund. The delegation from the United States wanted to see how ground leasing worked.

Eight people made the trip to Israel in June 1968. In addition to King, Swann, and Faye Bennett, the delegation included Slater King's wife, Marion; Lewis Black, a board member of the Southwest Alabama Farmers' Cooperative Association; and Leonard Smith, a colleague of Faye Bennett's at the National Sharecroppers Fund. The final two members of this delegation to Israel were Albert Turner, field director for the Southern Christian Leadership Conference in Alabama, and Charles Sherrod.

Sherrod had come to Albany in 1961 as an organizer for SNCC, the Student Non-violent Coordinating Committee. Earlier, while still a student at Virginia Union University, he had joined the first sit-ins of segregated department stores in Richmond. Soon after moving to Albany, he became part of the Albany Movement. Within that organization, he and his SNCC comrade, Cordell Reagon, were young, firebrand, grass-roots organizers, nipping at the heels of the more cautious black leadership. Long after Martin Luther King left town and the Albany Movement began to ebb, Sherrod stayed on, continuing to organize against segregated schools and other vestiges of Jim Crow. He also turned his efforts toward promoting better housing for the area's African American population. When invited by Slater King to join the trip to Israel, he quickly signed on.

After a month in Israel, these eight activists, six blacks and two whites, returned to the United States, convinced that something like a network of agricultural cooperatives, developed on lands leased from a community-based nonprofit, might be a powerful model for the rural South.<sup>25</sup> They introduced this idea at a July 1968 meeting in Atlanta to which they invited representatives of nearly every civil rights organization in the South with an interest in addressing the land problems of African Americans. A planning committee was formed to explore the feasibility of developing a leasehold model of rural development for black farmers.<sup>26</sup>

In mid-1969, bylaws drafted by C. B. King were approved by the planning committee. The name adopted by the committee was New Communities, Inc., described in the Articles of Incorporation as "a nonprofit organization to hold land in perpetual trust for the permanent use of rural communities."<sup>27</sup>

Three of the officers for this new corporation had accompanied Swann to Israel. Slater King was elected president. Faye Bennett was elected secretary. Leonard Smith, Bennett's colleague at the National Sharecroppers Fund, was elected treasurer. The corporation's vice president was an African American priest from Louisiana, Albert J. McKnight. Father McKnight, along with Charles Prejean, had represented the

Southern Cooperative Development Program and the Federation of Southern Cooperatives on the planning committee. At the time of New Communities' founding, Father McKnight already had a long history of helping to develop rural cooperatives and credit unions. It was hardly a reach for him to embrace the notion of a cooperatively managed farm and planned residential community to be located on land that was leased from a community-controlled nonprofit.<sup>28</sup>

The board of New Communities, under Slater King's leadership, began immediately looking for land. They took an option on 5,735 acres located in Leesburg, about 30 miles north of Albany, using a \$50,000 grant provided by the National Sharecroppers Fund. That left over \$1 million they still had to raise before their six-month option expired. The whole process was almost derailed one month later, when Slater King was killed in an automobile accident. Despite this tragedy, the board decided to press on. Charles Sherrod was asked to assume the presidency of New Communities, a position he retained for many years.<sup>29</sup>

New Communities, Inc., managed to close on the land on January 9, 1970, coming into possession of 3,000 acres of farmland and over 2,000 acres of woodland. It had to borrow most of the \$1,080,000 purchase price. This meant that, for the next 20 years, most of New Communities' profits from raising and selling its agricultural products—corn, peanuts, soybeans, watermelons, hay, and beef—went into servicing the debt on its land. Although several families moved into buildings that already existed on the land prior to its purchase by New Communities, no funds were ever secured from governmental agencies or accumulated from the farm's profits to build new housing or to develop the planned community envisioned by the organization's founders. Furthermore, New Communities faced the same resistance as Koinonia had experienced from the county's white-owned businesses and white farmers. As Charles Sherrod later recalled, "There was a time when [the white establishment] opposed us. They'd burn, and they'd fire at us; they threw one or two of us in jail."<sup>30</sup> By 1982, things had settled down. There was grudging acceptance by New Communities' white neighbors. But the economic risks of farming and the crushing debt on their land forced New Communities to sell 1,300 acres in the early 1980s. Five years later, they were forced to sell the rest.<sup>31</sup>

### **Guide to a New Model for Land Tenure**

But the loss of New Communities was still many years away when Bob Swann and three of his colleagues at the International Independence Institute, Shimon Gottschalk, Erick Hansch, and Ted Webster, began writing a book meant to describe the "new model for land tenure" being tried at New Communities. Swann, Hansch, and Gottschalk provided the content. Webster served as the book's overall editor with the assistance of Marjorie Swann.

*The Community Land Trust*, published in 1972, was built around Swann's experience working with New Communities, but it also drew practical lessons from older leased-land communities in the United States and Israel. It included, for example, the

complete text of the Bryn Gweled ground lease. The authors admitted that the new model they were proposing existed “only in prototype,” yet they managed to describe many of the key components of ownership and organization that characterize the CLT of today.<sup>32</sup>

In particular, both the membership and board of the nonprofit landowner were opened up for the first time to people from the surrounding community and beyond who neither leased nor lived on the nonprofit’s land. This was a direct legacy of Swann’s involvement with Koinonia Farm and New Communities. He had helped to mobilize national support for a beleaguered Koinonia when it was attacked and boycotted by southern racists. He had worked beside Slater King and other civil rights activists in seeking representation from “almost every Southern organization concerned with the land problem of blacks” in planning and establishing New Communities.<sup>33</sup> These activists understood that such a radical experiment in racial advancement could survive in the hostile environment of southeast Georgia only through the continuing participation of sympathetic outsiders who might never live at New Communities themselves. When Swann and his colleagues got around to suggesting an organizational structure for their new model, they saw the merit of involving a larger, supportive community in guiding and governing the CLT. They proposed that “a majority of the board membership should consist of people somewhat removed from the resident community,”<sup>34</sup> although they did not specify a particular board configuration. It was only later, several years after their book was published, that the staff of ICE happened upon the three-part structure that eventually became a distinguishing feature of the CLT’s board.<sup>35</sup>

Incidentally, it was Ted Webster who coined the name for this new model of tenure. After reading a rough draft of the manuscript that Swann and his colleagues had produced, he pointed out that they needed some way to differentiate their model from the intentional communities that had come before and from the conservation land trusts that were springing up across the United States. Webster innocently asked whether it might make sense to call the model a *community* land trust, in effect emphasizing the new organizational elements being grafted onto Borsodi’s model.<sup>36</sup> Swann, Gottschalk, and Hansch liked the idea. From that point on, they began calling their prototype a community land trust.

### **Operation: From Trusterty to Trusteeship**

With publication of the 1972 book, two of the three elements of the modern-day CLT were firmly in place, at least in theory. There was an ownership structure that established a new relationship between individuals and the land beneath their feet. There was an organizational structure that redefined the relationship between people living on the CLT’s land and those residing in the surrounding community, a re-

gional constituency both larger and more inclusive than the leaseholders who had populated and governed the land trusts created or inspired by Ralph Borsodi.

In practice, however, most of the CLTs formed in the decade that followed the incorporation of New Communities and publication of the first book about this new model for land tenure were organized on behalf of small groups of like-minded people. These homesteaders moved onto land that was leased from a nonprofit corporation to live in community with others who shared their social and political values.<sup>37</sup> Although they called themselves community land trusts, they were closer to being intentional communities—or, as Swann later called them, “enclaves.” They did not embrace the open membership and balanced board of the model that Swann and his coauthors had envisioned.

It was not until 1978 that two organizations appeared that were to incorporate both the leased-land structure of ownership and the community-based structure of organization that Swann and his colleagues at ICE had envisioned. Both of these CLTs were located in rural areas, one in East Tennessee and one on the coast of northern Maine. Significantly, even as they fully embraced the model portrayed in the 1972 book, they pointed the way toward operational features that were to nudge the model in a new direction.

### **A Preferential Option for the Poor**

The first of these CLTs was the Woodland Community Land Trust (WCLT). It was founded in 1978 by a former nun, Marie Cirillo, who had been doing community development work in the Appalachian Mountains of East Tennessee since 1967. While she was still a Glenmary Home Sister, a member of Marie’s religious community had gone to Boston for a year of study and had heard Bob Swann talk about community land trusts. When she returned to East Tennessee, she told Marie and the other sisters about this new model of land tenure, suggesting that it might hold potential for their work with impoverished people in Appalachia. The sisters pooled their funds and paid for Swann to visit East Tennessee sometime in 1973.

Although the sisters were immediately convinced of the worth of Swann’s ideas, it would take another five years before local residents of Rose’s Creek, where Marie had settled, were willing to try a CLT. Many of these mountain people were already living on leased land, since most of the land and nearly all of the mineral rights in their Appalachian county were in the hands of absentee corporate owners, either land companies or coal companies. These companies were willing to lease land to the locals, but they never sold it. And the terms of the leases were always heavily biased in favor of the landowner, with little security or protection for the lessee. Having experienced the dark side of land leasing, the Appalachian natives of Rose’s Creek were understandably cautious about starting a CLT.

Even after incorporating the Woodland Community Land Trust in 1978, another five years went by before the first houses were built on a 17-acre site owned by WCLT.<sup>38</sup>

When those houses were finished, WCLT's directors took a significant departure from the model that had been laid out in the 1972 book. They imposed resale controls on the houses. Drawing on the religious tradition of tithing, something quite familiar to the Southern Baptists who populated the hills and hollows around Rose's Creek, the Woodland CLT decided that homeowners would get 90 percent of the appraised value of their houses when they moved, leaving the other 10 percent in the house as a price reduction for future homebuyers.

Meanwhile, in northern Maine, another woman was leading the effort to establish a rural CLT. Sister Lucy Poulin and several other Carmelite nuns had come to Hancock County in 1968, settling in the town of Orland. They had supported themselves by sewing shoes for a Bangor shoe company. When the company closed in 1970, over 30 local women, including the nuns, were thrown out of work. The sisters responded by helping to form a sewing cooperative, where the women could work at home, making crafts that were sold through a storefront they opened on U.S. Route 1. HOME was the name they gave to their cooperative. The nuns later established a school and a daycare center for the co-op's members. They also organized Project Woodstove to deliver firewood to the elderly. Eventually, over 1,500 people were connected in one way or another to HOME Co-op.

Their next project was the construction of new housing. Sister Lucy took the lead in helping to start Self Help Family Farms in 1978. The aim of this organization was to settle low-income families in newly built homes on 10-acre leaseholds, where each family could enjoy a degree of self-sufficiency. The Covenant Community Land Trust was formed that same year to serve as the landholder, leasing out the land under these homesteads.<sup>39</sup>

From the beginning, Sister Lucy, like Marie Cirillo, regarded the CLT as a vehicle for helping and empowering low-income people who had been excluded from the economic and political mainstream. To express it in terms of her Catholic theology, there was a "preferential option for the poor." The CLT was not simply building houses; it was building a community of the dispossessed.

### **Development Without Displacement**

That philosophy of empowerment was shared by Chuck Matthei, a friend of Sister Lucy's who had come to her aid in helping to establish the Covenant CLT. Over the next 30 years, Matthei was to do more than any other person to weave into the institutional fabric of the CLT the preferential option for the poor that Marie Cirillo and Lucy Poulin had espoused for their own CLTs. By doing that, he gave new operational meaning to the "T" in CLT.

Matthei was the movement's Johnny Appleseed, traveling back and forth across the United States over the course of many years in a string of beat-up, secondhand vehicles, speaking to any audience he could find about the community land trust. He helped to convince hundreds of people to stop talking about CLTs and to go out and start one. As Marjorie Swann later observed, when reflecting on the surprising growth

of the movement her former husband had helped to spawn, the theoretical genius of a Ralph Borsodi or a Bob Swann was not sufficient to move CLTs into the mainstream. It took the motivational eloquence and political savvy of a Chuck Matthei to make the movement a reality.<sup>40</sup>

Matthei grew up in an affluent suburb of Chicago. A brilliant student, he was accepted to Harvard University. But he got sidetracked along the way. While still in high school, he had been regularly reading a newsletter published by a group of antiwar activists in Cincinnati known as the Peacemakers. This was the period right before Martin Luther King was assassinated, when King's philosophy of nonviolence had led him increasingly to combine his struggle against segregation with advocacy for the poor and opposition to the Vietnam War. This heady blend of civil rights, economic justice, and antiwar activism was precisely what the Peacemakers had been preaching since 1948, a moral concoction that Matthei found quite intoxicating. Graduating from high school in the summer of 1966, he hopped on his motorbike and headed to Cincinnati to meet in person the Peacemakers he had been reading about: Earnest and Marion Bromley, Wally and Juanita Nelson, and Maurice McCrackin.

To the fury of his father, Matthei never made it to Harvard. Instead, following in the footsteps of the Bromleys, the Nelsons, and McCrackin, Matthei became a life-long tax resister and social activist. He also became a close friend of Dorothy Day's, spending much time at the Catholic Worker house in New York City. Through the Peacemakers, he met Bob and Marjorie Swann. While on the staff of the Clamshell Alliance in New England, Matthei was befriended by Sister Lucy Poulin and helped her to start the Covenant CLT. That same year, in 1978, he was invited by Bob and Marjorie Swann to join the board of ICE, then headquartered in Boston.

One year later, ICE imploded. Mounting problems of personnel and finances precipitated the resignation of the entire staff and most of the board. When the dust settled, Chuck Matthei was made executive director, for a princely salary of \$300 per month.<sup>41</sup> Matthei moved ICE to Greenfield, Massachusetts, and began gradually replenishing its coffers and rebuilding its staff. By 1988, ICE was employing 21 people, operating a multimillion-dollar revolving loan fund for CLTs, publishing a nationally distributed periodical called *Community Economics*, and providing technical assistance to a growing number of CLTs across the country.

One of the first CLTs to receive financial and technical assistance from ICE, after Matthei was named executive director, was the Community Land Cooperative of Cincinnati (CLCC). This inner-city CLT was started by the West End Alliance of Churches and Ministries in 1980, with Matthei's help. One of its leaders was Matthei's old friend Maurice McCrackin, a Presbyterian minister whose church lay in the heart of the West End, Cincinnati's oldest and most impoverished African American community.

The CLCC was unlike all previous CLTs in applying the model for the first time to an urban environment. This was new territory. Up until that point, CLTs had been successfully seeded only in rural settings.<sup>42</sup> Despite its urban surroundings, however, the CLCC bore a striking resemblance to the CLTs that had been established by

Marie Cirillo and Lucy Poulin. Like the Woodland CLT and the Covenant CLT, it served a population that had been excluded from the economic and political mainstream. It was a product of grassroots organizing and a vehicle for community empowerment: a means for controlling the development and fate of an impoverished inner-city neighborhood while involving the neighborhood's residents in the CLT's activities and governance.

It was also a vehicle for controlling the resale prices of any homes developed through the CLT. The CLCC was created, in part, to serve as a bulwark against gentrification. Its founders believed that simply removing land from the speculative market would not do enough to preserve the affordability of CLCC's homes or to prevent the displacement of the neighborhood's lower-income residents. Earlier land trusts, including the single-tax communities, Bryn Gweled, and the residential enclaves inspired by the CLT book of 1972, had not imposed long-term contractual controls over the resale of buildings located on leased land. The 1972 book had not contemplated permanent affordability being one of the purposes of this new model of land tenure. It was mostly silent on the subject of how a CLT's homes were to be transferred from one owner to another, saying only that "fair procedures can be worked out for the sale of this immovable property when the owner decides to sell."<sup>43</sup> Rejecting this open-ended approach as too weak and uncertain to stem the tide of gentrification, the CLCC imposed permanent contractual controls over the pricing and conveyance of any homes developed on the CLT's lands.

### ***The Community Land Trust Handbook***

The founders of the Community Land Cooperative of Cincinnati, like many of the people who were attracted to the fledgling CLT movement in the 1980s—and whom Matthei was recruiting to staff a resurgent ICE—brought with them a new set of sensibilities. They shared many of the same values and heroes that had proved so influential for Bob Swann. They had come of age during the civil rights movement and protested the Vietnam War. Gandhi and Martin Luther King were two of their moral touchstones. But there were other influences, as well. People now working with local CLTs or joining ICE were more likely to have ties to the Catholic Worker or to faith-based organizations like community churches, religious orders, and ministerial alliances. Many more of them had experience as community organizers. A growing number of them came to a CLT or to ICE with prior experience working in urban neighborhoods or providing affordable housing for lower-income people. This influx of newcomers was to affect the ways and places the model was applied. It was also to alter, in time, what it meant to be a CLT, as new operational features like resale controls were added to the model's makeup.

By the 1980s, a new generation of community land trusts—and a new generation of CLT activists—were in need of a better blueprint for creating a CLT. Chuck Matthei pulled together a team of people to write and illustrate a book that would update and, in some cases, revise the model that Swann and his colleagues had proposed a

decade before. Eight of the book's twelve contributors had a background in community organizing. Six had experience with housing or city planning. Two had worked for faith-based organizations.<sup>44</sup>

*The Community Land Trust Handbook* was published by Rodale Press in 1982. It drew on the experience of newer CLTs like those in Cincinnati, Maine, and East Tennessee, while paying homage to the ongoing experiment at New Communities. Although building on the foundation of the earlier book, the *CLT Handbook* introduced several organizational and operational refinements to the model:

- There was a new emphasis on urban problems, especially the preservation of affordable housing and the revitalization of residential neighborhoods.
- There was a new emphasis on building the social and political base for a new CLT through grassroots organizing.
- There was a higher priority on serving disadvantaged individuals and communities, accompanied by a "moral responsibility" for helping lower-income leaseholders to succeed as first-time homeowners.
- The open membership that Bob Swann and Slater King had brought to New Communities was defined more specifically in terms of two distinct voting blocks—leaseholder members and community members—who were each assigned responsibility for electing one-third of the governing board.
- The permanent affordability of owner-occupied housing (and other structures), enforced through a preemptive option and resale formula embedded in the ground lease, was made a defining feature of the CLT.<sup>45</sup>

The *CLT Handbook* also assumed an assertive moral and political stance in suggesting that some forms of property are better than others: more virtuous, more responsible, more just. The best forms of property were declared to be those in which the "legitimate" interests of individuals and their communities are durably secured and equitably balanced. The book of 1972 had been concerned, first and foremost, with reforming the relationship between people and land. The overriding concern of the *Handbook* of 1982, by contrast, was reforming the relationship between individual and community—finding an equitable and sustainable balance between private interests and public interests that regularly collide in the ownership and use of real property. The challenge, as the *Handbook* readily admitted, was how to reach agreement on what those legitimate interests should be and on how they should be limited by one another. The property interests that the *Handbook's* authors were most comfortable calling "legitimate" were security, equity, and legacy. There was an individual dimension and a community dimension to each. A "satisfactory property arrangement" was described, accordingly, as one in which security, equity, and legacy were ensured for individuals who own homes and make use of land, without compromising a complementary set of community interests that are equally legitimate—public goods that must not be sacrificed to the single-minded pursuit of individual gains.

The CLT was extolled as a vehicle for securing this balance. In the CLT's structure of *ownership*, the rights and responsibilities of individual homeowners were balanced against those of the landowner. In its structure of *organization*, the powers of governance were balanced between people living on the CLT's land and people residing in the surrounding community. In its *operation*, the financial rewards from reselling a home were fairly allocated, balanced between a CLT's commitment to building wealth for the present generation of lower-income homeowners and its commitment to preserving affordability for future generations.

The bright moral thread running through all of the discussions was the programmatic priority that a CLT should give to solving the problems of low-income communities. In the vocabulary of the liberation theology of that period, there should be a "preferential option for the poor." Such a preference, using different words, was espoused repeatedly in *The Community Land Trust Handbook*, imbuing the "T" in CLT with new meaning.

The authors of the previous book on CLTs, in naming their "new model for land tenure," had explained their choice of the word *trust* by a "desire to emphasize Ralph Borsodi's idea of trusterty." Like Borsodi, they had argued that god-given resources like land, lakes, seas, and air, not being products of human labor, cannot be morally owned by individuals. These resources must be held in trust for the long-range welfare of all people. There was no suggestion, however, that some people might have greater needs than others or should be granted preferential access to the land trust's resources because of need.

Ten years later, the *Handbook* put forth a very different proposition. It was not only land that a CLT was to hold in trust, but the public's investment in developing the land, as well as the "unearned" increment in the appreciating value of houses and other improvements. It was not enough, moreover, for the CLT simply to act as the watchful steward for these resources. It had an affirmative obligation to use and develop its assets for the primary benefit of individuals who were socially and economically disadvantaged. It also had a moral responsibility to stand behind these individuals after they leased land and purchased homes through the CLT, helping them to maintain and retain their newly acquired property.<sup>46</sup>

Persons excluded from the economic and political mainstream were now assumed to have the first claim over a CLT's resources. Sister Lucy Poulin of the Covenant CLT, in an interview included in the *Handbook*, said it best: "We're talking about people who have never been accepted or had value in the community. And we're prejudiced in favor of these people—that's the community of people that we want as our community."<sup>47</sup> This was a notion of trust much closer to Gandhi's idea of "trusteeship" than to Borsodi's idea of trusterty.<sup>48</sup>

To be fair, it cannot be said that the model's potential for helping disadvantaged populations had been entirely ignored by the authors of the first CLT book. With New Communities as its centerpiece, an experiment that Swann and King had viewed as the harbinger of a homegrown Gramdan Movement to ease the plight of

impoverished African Americans, the book's argument for a new model for land tenure spoke to some of the same social concerns later given such prominence in *The Community Land Trust Handbook*. In the earlier book's concluding chapter, entitled a "Mandate for Action," four possible paths were identified for creating "relatively large-scale, significant community land trusts." One of these options was described as establishing "new rural or urban communities for the primary benefit of poor and minority groups."<sup>49</sup>

Nevertheless, it was possible to read the 1972 text as purely a treatise on the "land question," a call to homesteaders, communards, and back-to-the-land idealists to structure the ownership of land in their intentional communities in a different way. The Gandhian grace notes were easily missed in the Borsodian score. In fact, many of the people who were moved to action by the book read it in precisely that way. Overlooking both the organizational prescription for an open membership and the operational preference for promoting economic equality, they created land trusts that bore little resemblance to Swann and King's vision of a Gramdan Movement in America.

The tilt toward the disadvantaged was much harder to miss in the *Handbook* of 1982. Highlighted there was the CLT's potential for aiding lower-income people and for empowering lower-income communities. Indeed, six of the nine case studies included in the book featured stories of CLTs emerging out of grassroots struggles to prevent the displacement, improve the housing, and promote the interests of persons of limited means whose communities were being buffeted by disinvestment or gentrification. In each of these places, a CLT had been established to secure property and power for people with too little of either.

With publication of *The Community Land Trust Handbook*, all the pieces of the model known today as the "classic" community land trust were finally in place. There was a two-party structure of ownership, with a nonprofit corporation holding land and leasing it out to the owners of any buildings. There was an inclusive structure of organization, with a two-part membership and a three-part board. There was an operational commitment to the stewardship of any housing constructed on the CLT's land, with priority access for persons too poor to acquire a home on their own. The main duty of stewardship was to ensure the permanent affordability of these homes, achieved through the CLT's management and enforcement of resale controls embedded in the ground lease. Beyond this contractual obligation, moreover, the CLT was charged with responsibility for helping its leaseholders to hang on to their homes and to keep them in good repair. In the *Handbook's* words, "It is not enough to provide low-income people with land and financing for homes and then leave them to their own resources." A good steward does not expect people of limited means to go it alone. The CLT was durably, dependably there to help them succeed.

## Conditions of Growth: From Model to Movement

This reworking of the CLT was to have both practical and political advantages for a model that aspired to become a movement. By prioritizing populations, places, and activities recognized as “charitable” under Section 501(c)(3) of the federal tax code, CLTs gained access to financial resources from public agencies and private foundations that were not available to organizations that lacked this exemption.<sup>50</sup> By prioritizing problems recognized as harmful for constituencies and communities of limited means—including the declining affordability of housing, the deterioration of inner-city neighborhoods, and the displacement of lower-income persons uprooted by market forces or public policies—CLTs gained relevance and acceptance among policy makers and community activists who were struggling to respond to the federal retreat from housing and community development in the 1980s. As new resources and constituencies were drawn to the model, the number of CLTs began to grow.

Urban CLTs formed the leading edge of this expansion. Three years after the founding of the first urban CLT in Cincinnati, community land trusts were started in Syracuse, New York, and Burlington, Vermont. By 1990, others had appeared in Durham, North Carolina; Youngstown, Ohio; Albany and Schenectady, New York; Worcester, Massachusetts; and Washington, DC.

One of the most significant CLT start-ups during this period was Boston’s Dudley Neighbors, Inc., (DNI). DNI was established in 1989 as a corporate subsidiary of the Dudley Street Neighborhood Initiative (DSNI) for the purpose of acquiring, holding, and developing land for the revitalization of a multiracial residential neighborhood in the heart of Roxbury. Despite its subsidiary structure and the lavish funding it eventually received from private foundations and public agencies, DSNI/DNI was typical of many of the urban CLTs founded in the 1980s and early 1990s in espousing a dual commitment to community empowerment and community development. Its service area was a single, well-defined neighborhood with a historic sociopolitical identity. Its impetus came from the neighborhood’s opposition to a top-down plan for the redevelopment of Roxbury that had been put forward by the City of Boston and local foundations.<sup>51</sup> When DSNI/DNI later proposed its own comprehensive plan for the neighborhood’s redevelopment, it was the result of a participatory process of organizing and planning that engaged hundreds of community residents over many months. DSNI/DNI, like many emerging CLTs in other cities, viewed affordable housing as only one component of community development, a subset of the CLT’s overall mission of transforming the physical, economic, and political life of its place-based community.<sup>52</sup> When DSNI exhorted the residents of Roxbury to “Take a Stand, Own the Land,” it was not only so its CLT could secure buildable sites for affordable housing. It was also so a local community, through DNI’s long-term control over land and improvements, could control its own destiny.

As CLTs were sprouting up in a number of cities, new CLTs were also appearing in rural areas of Massachusetts, Maine, Vermont, New Hampshire, and Washington state. Notably, many of the rural CLTs started during the 1980s staked out a service area much larger than the territory served by their urban counterparts.<sup>53</sup> They conceived of their “community” as being an entire county, region, or, in the case of the first CLTs in Washington state, an entire island.<sup>54</sup> One of the first of these rural CLTs to be established, soon after the pioneering efforts of Marie Cirillo and Lucy Poulin, was the CLT in the Southern Berkshires. It was founded in 1980 by Bob Swann and Susan Witt, the year after they left ICE. They also created a companion organization, the E. F. Schumacher Society, which, among many other programs, offered assistance to rural communities in creating CLTs of their own.

*The Community Land Trust Handbook* had spoken rather grandly of a CLT *movement*. In truth, only a handful of community land trusts actually existed in 1982, the year of the book’s publication. Declaring these few CLTs a movement was like calling the first green shoots to appear in a muddy field a bumper crop. What was wishful thinking in the early 1980s, however, was becoming a reality by the middle of the 1990s. With a hundred CLTs scattered across the United States, the model was showing signs of actually becoming a movement.

How did this happen? How did a hothouse flower with unusual characteristics of ownership, organization, and operation become widely established, spreading from a few experimental garden plots in the Southeast and Northeast in the 1970s to more than 240 urban, suburban, and rural communities in 45 states and the District of Columbia? Many things combined to nurture such growth, so it is difficult to say for certain why this fledgling movement was able to thrive, but a handful of factors were arguably the most important, including a timely change in the political and economic climate; the standardization of CLT definitions, documents, and practices; the cross-pollination of ideas and techniques among CLT practitioners; an increase in private and public investment, boosting the productivity of CLTs; and diversification in the model and movement, invigorating both.

## **Climate**

With the presidential election of Ronald Reagan in 1980, the federal government beat a hasty retreat from the field of affordable housing, repudiating the national commitment to a “decent home and suitable living environment for every American family” that had been endorsed by both political parties since the Housing Act of 1949. The deterioration of affordable housing and other symptoms of disinvestment afflicted many residential neighborhoods. Gentrification hit many others. Homelessness, largely invisible since the Great Depression, reappeared with a vengeance. At the same time, affordability controls began expiring on thousands of units of publicly subsidized, privately owned rental housing built nearly two decades before under federal programs like 221(d)(3) and Section 8. These so-called expiring-use projects provoked a new

awareness of the social cost of failing to require long-term affordability in housing produced with public funds.

The mid-1980s was also a time when the price of owner-occupied housing began a steady 20-year climb, even as household incomes stagnated for the bottom three quintiles of the population and mortgage interest rates rose to historic heights. A new phrase entered the lexicon of public policy, the “affordability gap,” the widening chasm between housing prices and household incomes.

As affordability became the nation’s predominant housing issue, affecting both rental housing and homeowner housing, the confidence placed in traditional tenures was somewhat shaken. They seemed increasingly to be incapable of protecting and preserving affordable housing, especially in markets that were very hot. The CLT, by contrast, was specifically designed and uniquely positioned to do what market-driven models could not. As Chuck Matthei argued at the National CLT Conference in Atlanta in 1987, “No program, public or private, is a true or adequate response to the housing crisis if it does not address the issue of long-term affordability. It’s time to draw the line politically. This is a practical challenge that confronts policymakers; it’s the practical challenge that confronts community activists; and, happily, it is a practical challenge that the community land trust model has an ability to meet.”

For the first time, both policymakers and community activists were listening. Municipal officials, in particular, became increasingly receptive to the argument that government could not afford to put more and more resources into closing the affordability gap, if this investment was going to be quickly lost. Permanent affordability began to look like a prudent course of action, a policy more fiscally responsible and politically defensible than previous governmental practice. As preservation rose higher on the public agenda, particularly in places where market prices were soaring, the number of CLTs began to grow.

To the surprise of many observers, the same proved true when prices started to plummet. By the end of 2006, it was no longer the affordability crisis that was grabbing headlines in the United States, although an affordability gap persisted in many housing markets; it was the foreclosure crisis. This, too, caused the number and acceptance of CLTs to rise.

The reason was not hard to see. CLTs do not disappear after selling a resale-restricted home. They stand behind the deal: intervening in cases of mortgage default, preventing foreclosures, backstopping the homeownership opportunities they have worked so hard to create. Stewardship is what CLTs do best. True, they also acquire land, develop housing, sell homes, organize communities, and a dozen other things, but so do a lot of other nonprofit housing developers. What the CLT does better than any other organization—its specialized niche in a densely populated nonprofit environment—is to preserve affordability when economic times are good and protect its homes and homeowners when times are bad. In the scorched landscape of the national mortgage crisis, CLTs were almost alone in reporting few defaults and even fewer foreclosures.<sup>55</sup> Such a stunning performance in a time of crisis attracted wider notice and greater

governmental support for this unconventional model of homeownership.<sup>56</sup> This helped the movement to grow.

### Cultivation

The second factor contributing to the proliferation of CLTs in the United States was the dissemination of educational materials, organizational documents, and “best practices” employing a consistent conception of the CLT. Early on, the leading role in nudging CLTs toward more standardization in the way their stories were told, their organizations were structured, and their programs were managed was played by the Institute for Community Economics, formerly The International Independence Institute (III). Over time, other actors and organizations came to play a larger part, eventually eclipsing ICE.<sup>57</sup>

ICE produced the first books about CLTs: *The Community Land Trust: A Guide to a New Model for Land Tenure in America* and *The Community Land Trust Handbook*. ICE introduced the CLT to an even wider audience through *Common Ground*, a narrated slide show about the Community Land Cooperative of Cincinnati, completed in 1985, and *Homes and Hands: Community Land Trusts in Action*, a video featuring CLTs in Durham, North Carolina; Albuquerque, New Mexico; and Burlington, Vermont, completed in 1998. The images and stories presented in these productions were clearly designed to persuade an audience of the model’s practicality and worth. They served another function besides. They were not only promotional; they were also educational, instructing the audience in the particular features and purposes of the model described in the 1982 *Handbook*. They created a consistent message and common understanding of what it meant to be a CLT.

ICE also turned its attention to producing technical materials for a very different audience: lawyers who were working with CLTs. Employing the same approach it had used in writing *The Community Land Trust Handbook*, ICE pulled together a team of attorneys and CLT practitioners to develop a set of “model” documents and standard procedures for incorporating CLTs, leasing land, designing resale formulas, and a dozen other legal and technical details pertaining to the organization and operation of a CLT. These materials were collected in *The Community Land Trust Legal Manual*, published in 1991. A second edition, revising and updating the original, was published in 2002.<sup>58</sup>

Critical, too, to inculcating a common conception of the model was the CLT definition that was incorporated into federal law in 1992. With passage of the National Affordable Housing Act (NAHA) in 1990, cities and states began using pass-through funds from the federal government to support the projects and operations of what NAHA called “Community Housing Development Organizations.” CLTs not only had an interest in securing their eligibility for this funding, they also wanted to make sure that the way in which a CLT was defined in federal law was consistent with the way that most CLTs, after 1982, were defining themselves. Not trusting the federal bureaucracy to describe fully and accurately the essential elements of ownership, organization, and operation that had been laid out in *The Community Land Trust*

*Handbook*, a decision was made by a small group of CLT advocates to beat HUD to the punch. They asked Congressman Bernie Sanders, whose administration had initiated and supported the Burlington Community Land Trust when he was mayor of Burlington, Vermont, to insert their definition of a community land trust into the Housing and Community Development Act of 1992.<sup>59</sup> Sanders shepherded this amendment through Congress and saw it signed into law without modification.

The most significant contribution in recent years to the cultivation of common standards—and higher standards—for explaining, organizing, and operating CLTs has been made by the National Community Land Trust Academy. Founded in 2006 as a chartered program of the National Community Land Trust Network, the academy has two purposes: to provide comprehensive training on theories and practices unique to CLTs, setting a high standard for practitioner competence; and to support research and publication on the best practices emerging from the field.<sup>60</sup> The Academy has not only been concerned with the nuts and bolts of making a CLT work; it has also tried, in its courses and publications, to cultivate a common understanding of the history and values underlying the CLT, reminding proponents and practitioners of where the model came from and why it is structured as it is.

None of these efforts made every CLT look and act exactly the same. Increasing the clarity and consistency of the messages, materials, documents, and practices of the nation's CLTs did little to deter the movement's diversification. But it did provide public officials, private lenders, and community activists outside of the movement with a sharper picture of how a CLT was structured, how it was different from other models of tenure, and how its projects might best be funded and financed. It also provided practitioners inside the movement with a common vocabulary for exchanging information about what worked well—and what did not—in a model of tenure that was still very much a work in progress.

### **Cross-Pollination**

Peer-to-peer exchanges were essential to turning an untested, experimental prototype into a practical model that was fully operational. The audacious pioneers who started dozens of CLTs in the 1980s and 1990s were, in many respects, making it up as they went along. They crafted legal documents, designed resale formulas, arranged mortgages, sold homes, and adopted policies and procedures for a form of tenure with virtually no track record. They learned by doing. And they learned from one another.

Some of their communication was indirect, information they gleaned about each other's programs and procedures by reading *Community Economics*, a newsletter published and distributed by ICE from 1983 to 1996.<sup>61</sup> The stated purpose of this publication was to "strengthen the connections between the theory and practice of community economics," but it also strengthened the connections among far-flung CLTs. In an average year, two or three issues would be mailed out to hundreds (and later thousands) of people across the United States, many of whom were in the early stages

of planning, organizing, or operating a CLT. This was a model and movement in flux. As ICE observed in the newsletter's maiden issue, published in summer 1983, things were changing so rapidly that it was hard for anyone to keep abreast of the latest developments; hence the need for *Community Economics*:

Since finishing work on *The Community Land Trust Handbook*, we at ICE have been concerned with the need for some regular, ongoing publication to carry news of CLTs and related developments in the area of community economics. The *Handbook* brought the record on CLTs more or less up to date as of Autumn 1982, but now there are new developments to report—new groups, new interest, and new issues being confronted by established CLTs as they expand their programs.

Many issues of *Community Economics* profiled a particular CLT. Every issue carried news of resources that local CLTs were discovering, projects they were developing, or programs they were designing, information with relevance for CLTs in other communities. For 14 years, this newsletter pollinated the movement with new ideas, helping one CLT to learn from the mistakes and successes of others.

Interorganizational learning among CLT practitioners also happened more directly at national conferences convened every few years by ICE. The first conference was held in 1987 in an African American church in Atlanta,<sup>62</sup> a fitting venue since the country's first CLT had been organized in southeast Georgia nearly 20 years before by veterans of the civil rights movement. One of those veterans, John Lewis, who had attended the early planning sessions for New Communities, was on hand to remind the conference's participants of the CLT's roots, while applauding how far the model had come. The main business of the Atlanta conference, however, like all that followed, was the face-to-face exchange of stories, ideas, and technical information among people who were trying to get organizations and projects off the ground. Everyone had something to learn, and, because the model itself was so new, anyone with more than a year of CLT experience had something to teach.

Every two or three years thereafter, ICE convened another national conference, drawing together hundreds of CLT practitioners from across the United States and, on occasion, from Canada, England, and Australia, as well.<sup>63</sup> The 2003 conference in Syracuse, New York, was ICE's last. By the start of the new millennium, ICE's star had begun to fade, even as other national and regional organizations were beginning to play a larger role in assisting and connecting local CLTs. When ICE abruptly canceled the conference that had been scheduled for Portland, Oregon in 2005, an ad hoc coalition of CLT executive directors, funders, and consultants stepped forward to fill the vacuum.<sup>64</sup> They revamped the costly conference that ICE had planned, transforming it into a grassroots gathering of CLT practitioners sharing information and best practices in a series of peer-to-peer workshops. They also set aside half a day for CLT leaders from around the country to confer about a possible future without

ICE, since it looked like this national organization, which had provided so much support for CLTs in the past, was winding down.

Beginning with the conference in Portland, the nation's CLTs in effect took control of their own movement. This meant not only assuming responsibility for organizing future conferences, where practitioners could continue to learn from one another. It also entailed creating a new corporate structure for ensuring regular communication and coordination among hundreds of organizations scattered across the United States. The foundation for this interorganizational structure was laid down in Portland with the election of a steering committee charged with the task of drafting bylaws for a national association of CLTs. One year later, in Boulder, Colorado, these bylaws were refined and ratified by representatives from 51 CLTs. The National Community Land Trust Network was formally incorporated in June 2006.<sup>65</sup>

This greatly intensified the interaction and communication among the country's CLT practitioners. Under the auspices of the National CLT Network, there was now an annual gathering of practitioners. These national conferences included day-long trainings and half-day seminars offered by the National CLT Academy, along with membership meetings, faculty meetings, and board meetings for the Network and the Academy.<sup>66</sup> The Network's contribution to facilitating the flow of information and ideas among CLT practitioners was not confined to these annual conferences, however. The boards and committees of the Network and the Academy, made up predominantly of staff members and board members of local CLTs, met frequently throughout the year. The Network's listserv and web site provided other ways for CLT practitioners, old and new, to ask questions, solve problems, and share techniques. The same function that *Community Economics* had once served through the infrequent distribution of a printed newsletter was now being fulfilled regularly and instantaneously via the Internet.

Outside of the network, cross-pollination occurred in other ways, as well. The E. F. Schumacher Society, founded by Bob Swann and Susan Witt in 1980, and Equity Trust, which Chuck Matthei had founded in 1990, maintained web sites and brokered connections among different groups of grassroots organizations. Most were not members of the National CLT Network, but many were either structured as CLTs or engaged in applying land leasing and other components of the CLT model to conserving open space, preserving farmland, or promoting community supported agriculture. Peer-to-peer communication among CLTs was also spurred by the rise of regional CLT networks in the Pacific Northwest, Minnesota, and Colorado. While maintaining close ties to the National CLT Network, these regional networks operated quite independently: forging connections among their members; advocating for changes in state policy; sharing information about organizational policies, procedures, and administrative systems; and raising the standard of practice for every CLT in their region.<sup>67</sup>

In the early years of the movement, no one had any real experience in starting or operating a CLT, except those intrepid souls who were actually doing it. Nearly every pioneer was learning something worth sharing with everyone else who was blazing a

similar trail. Nobody was an “expert,” so everybody was. That remained true, even as the movement matured. A cadre of consultants gradually arose, drawn mostly from the staff of ICE or from the ranks of CLTs, but that was never a substitute for CLT practitioners swapping information with one another, directly or indirectly. The real experts remained those who were governing or running a CLT day to day. Keeping them connected has been an essential ingredient in the movement’s growth.

### Fertilization

Every CLT requires an abundance of financial resources to acquire land, develop housing (and other buildings), create affordability for low-income people, and sustain the operations of a nonprofit organization with stewardship responsibilities lasting close to forever. The lack of money, both equity and debt, was an impediment to CLT growth in the early years. The greater availability of public grants and private loans supporting CLTs and their projects has been an inducement to growth in more recent years.

Unable to access capital from more conventional sources, many of the first CLTs were forced to resort to what *The Community Land Trust Handbook* once described as the “miracle theory” of finance:

Appropriate financing relies upon prior financial planning to match particular types and sources of funds with particular needs and uses for funds. Miracle financing awaits the lucky arrival of adequate funds to meet immediate needs: like manna from heaven, such funds may be urgently needed and patiently awaited, but hardly expected or prepared for. The latter cannot, of course, be lightly dismissed. Considering the remarkable accomplishments of numerous grassroots groups operating on shoestring budgets with little hope of long-term financial support, the miracle theory of finance must be credited with many good works and substantial social progress. Miracles do happen.<sup>68</sup>

Very few of the first CLTs got started without an occasional dose of “miracle financing” from a wealthy individual, a local church, a national religious order, or a faith-based charity like the Campaign for Human Development.<sup>69</sup> At ICE, Chuck Matthei was quick to recognize how important such small infusions of cash could be in nurturing the growth of CLTs. Instead of attempting to assemble large pools of capital from private investors, as ICE had tried to do with little success in the 1970s, Matthei looked for a way that small loans, offered at low rates of interest by socially motivated individuals or institutions, could be mobilized to help CLTs get their first projects off the ground. In 1979, soon after becoming ICE’s executive director, he established a revolving loan fund at ICE for the purpose of accepting no-interest and low-interest “social investments” that could be relented to local CLTs. The fund was modest in scale. By 1983, its assets totaled \$643,590. It had made 45 loans to CLTs,

limited-equity housing cooperatives, worker-owned businesses, and community service groups. The average loan size was only \$14,302.<sup>70</sup> By the end of 1985, the fund's assets had doubled, but the size of an average ICE loan remained relatively small, only \$26,065.

Despite their size, these loans often made a critical difference to start-up CLTs, helping them to acquire their first parcel of land or rehabilitate their first house while building their credibility with public funders and private lenders. Just as important, ICE's own experience in building and managing its in-house loan fund—and seeing the impact these timely loans could make on seeding and supporting local CLTs—persuaded Matthei to expand ICE's technical assistance program beyond CLTs. Using ICE's revolving loan fund as the model,<sup>71</sup> Matthei and other staff from ICE began working with coalitions of social investors and community activists to establish a variety of community development loan funds, including funds in New Hampshire, Boston, and Philadelphia. In 1985, ICE convened a national conference on community development loan funds, attended by representatives from 35 nonprofit lenders. Out of this conference emerged the National Association of Community Development Loan Funds, chaired by Matthei for its first five years.<sup>72</sup>

Community loan funds (as Matthei called them) and community land trusts developed on parallel tracks, complementing and supporting each other. CLTs were never the only beneficiaries of these alternative financial institutions, but they got loans when they needed them, especially during the years when start-up CLTs were having difficulty obtaining funding from local governments, which they were often fighting, or obtaining financing from local bankers who were initially uncomfortable making loans for houses on leased land.

Two breakthroughs occurred in the early 1990s that somewhat eased both difficulties. The 1992 amendments to the National Affordable Housing Act did more than provide a standard definition of CLTs. They cracked open the door to federal funding. After 1992, many more CLTs were able to receive designation as a Community Housing Development Organization (CHDO). Many more were able to receive funding from the federal HOME program for their operations and their projects.<sup>73</sup> Equally important, federally supported technical assistance was made available to CLTs for the first time.<sup>74</sup> In November 1994, the U.S. Department of Housing and Urban Development (HUD) awarded ICE a three-year \$470,000 technical assistance grant. With these funds (and two later technical assistance grants from HUD), ICE seeded CLTs in several states where none had existed, nurtured dozens that were just getting started, and helped many existing CLTs to become more productive.<sup>75</sup>

Around 1992, as well, at the request of local CLTs and the urging of ICE, Fannie Mae began developing riders to be used in combination with CLT ground leases. This boosted confidence in the CLT among private lenders and made mortgage financing more widely available for resale-restricted homes on land leased from a CLT. Even when a banker did not use Fannie Mae's rider or take advantage of the special loan product that Fannie Mae later developed for CLTs, there was less resistance to

backing a model that Fannie Mae had recognized as a reasonable and bankable approach to homeownership.<sup>76</sup>

As crucial as these changes at the federal level have been in nourishing the growth of CLTs, most of the action in boosting CLT productivity in recent years has come from policy changes and new sources of financial support at the municipal level. Local government, here and there, has become an enthusiastic partner. This was not always the case. Relations between cities and CLTs, for most of the CLTs' early history, were chilly, to say the least. As *The Community Land Trust Handbook* once described it, "Most interaction between CLTs and municipal officials has been marked by benign indifference, with neither party doing more than is minimally required to meet whatever legal obligations each might have with regard to the other." Their actual relationship was often stormy and strained. In many a neighborhood like the West End of Cincinnati, the main impetus for starting a CLT was to protect the community *against* municipal priorities, projects, or plans. The same people who played the lead role in organizing a CLT had spent years fighting city hall before the CLT appeared. Hostilities did not cease when the CLT came along.

Opposition to local government has remained a motivating factor in many low-income communities, especially in communities of color, where CLTs have continued to be erected as an institutional barrier against market pressures made worse by the actions or indifference of city hall. Over the last decade, however, a countertrend has emerged. There are now an increasing number of cities, counties, and towns where CLTs receive political support from municipal leaders, administrative support from municipal staff, and financial support from municipal coffers.<sup>77</sup> In these places, the CLT has become a partner of local government, an ally rather than an antagonist.

This signals a seismic shift in municipal policy. Instead of allowing homeownership subsidies to be pocketed by homeowners when reselling their assisted homes, a common practice in the past, many municipalities are now looking for ways to lock those subsidies in place. Instead of allowing the affordability of publicly assisted homes to lapse, many municipalities are now looking for ways to make affordability last. This has made the CLT, along with several other forms of resale-restricted, owner-occupied housing, a favored recipient of municipal largess and has helped CLTs to grow.

### **Hybrid Vigor**

In plant breeding, when two species with very different characteristics are combined, engendering an increase in size, yield, and performance beyond either of the parents, that salubrious result is known as hybrid vigor. Something similar has happened in the development of CLTs. Both the model and the movement are hybrids. The model was created by selecting favorable characteristics of ownership, organization, and operation from different strains of social change and combining them to form a new breed of tenure. The movement has prospered by mixing uses and merging agendas, bringing together organizational characteristics and political interests that are usually separate and frequently at odds. Over time, hybridization has brought into

dominance the most productive and sustainable characteristics of the CLT and helped it to thrive.<sup>78</sup>

Hybridization continues, altering the CLT in significant ways. These changes have been spurred by four developments: decentralization of the support structure for CLTs, diversification in the application of CLTs, municipalization in the formation of CLTs, and regionalization in the area served by CLTs.

### *Decentralization*

Over a forty-year period, the Institute for Community Economics went from being the center of the CLT universe to being one star among many and, finally, to being broken into pieces and propelled into orbit around brighter bodies. By 2008, ICE's most important intellectual properties, including *The CLT Legal Manual* and the *Homes and Hands* video, had been conveyed to Equity Trust; its revolving loan fund had been transferred to the National Housing Trust; and its archives had been boxed and mailed to the E. F. Schumacher Society. ICE's preeminent role as promulgator of CLT standards, convener of CLT conferences, and national clearinghouse for news and research about CLTs had been taken over by the National CLT Network. Technical assistance for new and existing CLTs, moreover, once the exclusive purview of ICE, was now provided by a wide assortment of national intermediaries, regional coalitions, private consultants, and even a few of the larger CLTs. With so many actors now saying what a CLT is—and how it should be organized and operated—there was no longer one version of the model, but many.

### *Diversification*

Although Swann and his coauthors in 1972 had envisioned multiple applications for their new model of land tenure, the CLT came to be used most widely for the development and stewardship of affordable housing. Single-family houses, in particular, predominated among the early CLTs, since a majority of them were located in rural areas. As the model moved into city and suburb, however, its applications and activities became more diverse. The CLT was applied to other types and tenures of housing, including multiunit condominiums, limited-equity cooperatives, nonprofit rentals, homeless shelters, and manufactured housing in resident-owned parks. It was used to acquire and lease land under mixed-use buildings, community gardens, commercial greenhouses, social enterprises, and social service facilities. Back in the countryside, the CLT was being applied in novel ways to farming, forestry, and conservation, mixing community supported agriculture with community ownership of land; mixing affordable housing with the preservation of farmland, wetlands, and open space. Since form follows function, these new applications have sometimes reshaped the CLT. Some CLTs, for example, have been doing rental projects in which the CLT owns and manages both the land and building. Conversely, some CLTs have become involved with residential (and commercial) condominiums where the CLT owns neither the land nor the building, holding instead an affordability covenant on units

sprinkled throughout a larger residential complex. As the ways the CLT is applied have grown more diverse, so have the ways the CLT is structured, especially in the ownership and operation of real property.

### *Municipalization*

As the level of support from local government for CLTs has increased, the role played by municipalities in the life of a CLT has changed. Instead of waiting passively for a CLT to form, municipal officials in a number of cities have taken the initiative in starting one. Involved from the outset in planning and designing the CLT, city hall has sometimes been reluctant to let go, unwilling to be relegated to minority status in choosing the board and guiding the organization after it is established. Municipal support in some cities has also changed the CLT's mission and role. Where a local government has backed a CLT primarily for the purpose of serving as the long-term steward for affordable homes created by the investment of municipal funds or the imposition of a municipal mandate like inclusionary zoning, the municipality may not want the CLT to diffuse its focus by doing community development, as well. It may not want the CLT to do the kind of grassroots organizing that can occasionally lead to a neighborhood's residents fighting the same local government that is funding the CLT. City-CLT partnerships have sometimes produced CLTs, in other words, that are operated and structured much differently than CLTs in the past.

### *Regionalization*

Twenty years ago, the territory served by the typical CLT was a single inner-city neighborhood or, in more rural areas, a single valley, island, village, or town. Today, an increasing number of CLTs, old and new, are staking out a much larger service area. They acquire lands, develop projects, and draw members from an area encompassing an entire city, county, or region. A couple of CLTs have even organized themselves on a statewide basis, coordinating and supporting the development of local CLTs across an entire state.<sup>79</sup> As their territory expands, CLTs multiply their opportunities for acquiring land, building housing, and cultivating the kind of public and private partnerships that can help to bring the CLT to scale. At the same time, their connections to community get stretched and thin. Organizationally, the CLT may retain an inclusive membership and a popularly elected three-part board, structures designed to keep the CLT accountable to the constituency it serves. Operationally, however, a CLT whose membership is spread over a metropolitan area containing millions of people or over a three-county region covering hundreds of square miles is going to have a different relation with its "community" than a CLT that is focused on and accountable to a single neighborhood or town. Size matters, affecting what a CLT is and does.

Decentralization, diversification, municipalization, and regionalization have accelerated the process of experimentation that has been going on among CLTs since the beginning. Hybridization has improved their performance and raised their productivity.

Hybrid vigor has helped the CLT to spread. On the other hand, while it has clearly been a boon for the movement, there is also a risk that too much hybridization could become a bane for the model, diluting or extinguishing characteristics that have made the CLT unique. Three challenges loom the largest in this regard:

- Will there still be a place for community in the organizational structure of the CLT, or will the heightened influence of local government or the expanded territory served by a CLT remove or reduce the active voice of local residents in governing the CLT?
- Will land still matter in the ownership structure of the CLT, or will a focus on affordable housing, in general, and the stewardship of multiunit housing, in particular, cause CLTs to ignore other uses of land or to abandon land leasing altogether in favor of selling the land and using deed covenants to preserve affordability?<sup>80</sup>
- Will the CLT still espouse an operational preference for the disadvantaged—holding lands in trust, keeping homes affordable, and protecting security of tenure for people with limited resources—or will the Gandhian legacy of trusteeship be lost in a frenetic scramble to increase the scale and broaden the appeal of the CLT?

A contest for the soul of the community land trust is contained in these questions, a contest that decentralization, diversification, municipalization, and regionalization have made more acute. How they are answered in the years ahead will determine whether the CLT of tomorrow continues to resemble the model of today.

There are reasons to believe that it will. The roots of the CLT run deep. Tended by the first generation of CLT practitioners, many of whom are still alive, and preserved for the next generation by institutions like the CLT Academy, the E. F. Schumacher Society, and Equity Trust, the ideas and values that gave rise to the CLT continue to ground it and nourish it. They give resiliency to a model buffeted by change, allowing it to bend without uprooting its core commitments.

Not all of the changes swirling around the CLT compel it away from what it has been. Some coax it back, returning the model to its roots. The recent focus on stewardship is one example. The revival of interest in the CLT among communities of color is another. When a CLT is asked to serve as the long-term steward for land-based assets donated or subsidized by the public, the CLT returns to the job it was designed to do. Land and other socially created assets are removed from the market, placed in common ownership, and held in trust for future generations.<sup>81</sup> When a CLT is formed by residents of an African American or Hispanic American community to resist market forces and public policies that are fueling the loss of minority-owned lands and eroding the community's residential security and historic identity, the CLT returns to a cause that animated its earliest days. The CLT serves simultaneously as a bulwark against displacement, a tool for development, and a vehicle for the empowerment of communities defined, in part, by their relation to place.<sup>82</sup>

In sum, internal changes and external pressures are pushing the CLT toward a future in which the model may come to look very different than it does today. At the same time, deeply rooted principles and recently revived applications are pulling the CLT in the opposite direction, reinvigorating elements of ownership, organization, and operation that have historically characterized the “classic” CLT. The past is not dead, William Faulkner once wrote, it is not even past. That has remained mostly true for the CLT, until now. Across years of experimentation and evolution, the model has occasionally strayed from the vision and values of its founders, but it has usually found its way back. The past may not always be so influential, however. A long time coming, the CLT still has a long way to go.

## NOTES

Several reviewers helped in checking facts and correcting mistakes in an earlier draft of this chapter. The author wishes to thank Julie Orvis, Bonnie Acker, Kirby White, Marjorie Swann, and Lisa Byers for casting critical eyes on a historical narrative that covers lots of ground in relatively few pages. Any errors that remain, including those of selection and interpretation, are the author’s responsibility alone.

1. Thorstein Veblen, *Absentee Ownership and Business Enterprise in Recent Times: The Case of America* (New York: B. W. Huebsch, Inc., 1923).

2. Paine: “Man did not make the earth, and though he had a natural right to occupy it, he had no right to locate as his property in perpetuity on any part of it. . . . It is the value of the improvement only, and not the earth itself, that is individual property.” Jefferson: “The earth is given as a common stock for men to labor and live on.” Lincoln: “The land, the earth God gave man for his home, sustenance, and support, should never be the possession of any man, corporation, society, or unfriendly government, any more than the air or water.”

3. Here, too, George proved to be a faithful student of John Stuart Mill, who had written, “The ordinary progress of a society which increases in wealth, is at all times tending to augment the incomes of landlords; to give them both a greater amount and a greater proportion of the wealth of the community, independently of any trouble or outlay incurred by themselves. They grow richer, as it were in their sleep, without working, risking, or economizing. What claim have they, on the general principle of social justice, to this accession of riches? In what would they have been wronged if society had, from the beginning, reserved the right of taxing the spontaneous increase of rent, to the highest amount required by financial exigencies?” (“On the General Principles of Taxation,” in *Principles of Political Economy with Some of Their Applications to Social Philosophy*, 1848; repr., New York: Oxford University Press, 1994).

4. Howard’s book became a seminal text in city planning, heavily influencing people like Lewis Mumford, Clarence Stein, Frederick Law Olmsted, and many other American pioneers of urban design.

5. In addition to the writings of Henry George, Borsodi’s thinking about property was influenced the most by his reading of John Locke, in whose works moral title to property was seen as resting exclusively on an owner having put his own labor into the thing made. There is also an echo in Borsodi’s work, though unacknowledged by him, of the distinction made by R. H. Tawney between “passive property” and “active property.” See Tawney’s “Property and Creative Work,” in *The Acquisitive Society* (New York: Harcourt Brace Jovanovich, 1920).

6. In 1945, the other homeowners decided they wanted to gain individual title to the land beneath their feet. Borsodi moved the School of Living to Ohio, relocating to a farm that was owned by John and Mildred Loomis. Borsodi and Mildred Loomis began publishing a newsletter soon after, named *Green Revolution*. This periodical helped to spread Borsodi's ideas and other theories of what Loomis came to call "decentralism."

7. The impetus for this leased-land community is described on the Bryn Gweled web site ([www.bryngweled.org](http://www.bryngweled.org)) as follows: "Rampant real estate speculation was exacerbating poverty and disenfranchisement. Henry George's approach held hope of finding ways to stem this rising tide. A contemporary visionary was Ralph Borsodi, whose School of Living near Suffern, NY, attracted the attention of the group. Several people made an expedition to the School of Living and brought back enthusiasm and useful ideas about how small homesteads in a cooperative setting could enable a degree of self-sufficiency." Bryn Gweled means "hill of vision" in Welsh.

8. Antioch had been founded in 1852 by Horace Mann, a progressive educator. Antioch was the first college in the country to admit both women and African Americans.

9. Morgan drew inspiration from John Dewey's theories of progressive education and from his own professional career as someone who had learned engineering by doing engineering. He was also heavily influenced by the utopian ideas of Edward Bellamy, the author of *Looking Backward*.

10. After World War II, the land underlying Norris, Tennessee, was sold by TVA to private investors.

11. Another large-scale example of new town development on leased land began in Australia around the same time. When Henry George visited Australia and New Zealand in 1890, he found an appreciative audience for his ideas. Twenty years later, his followers shaped the development of the Australian Capital Territory. Established by parliament in the Seat of Government (Administration) Act of 1910, the Australian Capital Territory was created as a special governmental district for the country's new capital, Canberra. George's influence (and perhaps Howard's, as well) can be seen in the Act's stipulation that "no Crown lands in the territory shall be sold or disposed of for any estate of freehold." The land was to be owned forever by the commonwealth and leased, not sold, to the owners of any buildings constructed thereon. This was done to discourage speculation and to defray the expense of building Canberra, "allowing unearned increments in land value to be retained by the Commonwealth Government."

12. There was also no control over the resale price of Bryn Gweled's homes, an operational feature not added to the CLT until the 1980s. Compared to the affluent suburbs that surround it, Bryn Gweled is more racially and economically diverse. Indeed, it calls itself "an intentionally diverse community." But its houses have become quite expensive over time.

13. Although nearly all CLTs are nonprofit corporations—or subsidiaries of nonprofit corporations—not all CLTs are exempt from federal taxes under Section 501(c)(3). Either they have not sought such an exemption, or their purposes and activities do not qualify them for such an exemption.

14. Robert Swann, "The Community Land Trust: Borsodi and Vinoba Bhave," in *Peace, Civil Rights, and the Search for Community: An Autobiography*, chapter 18. Available online from the E. F. Schumacher Society, Great Barrington MA, [www.smallisbeautiful.org/publications.html](http://www.smallisbeautiful.org/publications.html).

15. Rustin was to become one of the most influential leaders and strategists of the American civil right movement, although he was often forced to work behind the scenes because he was gay. He was a cofounder of the Congress on Racial Equality and a close advisor to Martin Luther King Jr. The 1963 March on Washington was Rustin's idea, and he served as its principal organizer.

16. Tom Long, "Robert Swann, 84, Peace Activist Who Sought Land Reform," obituary, *Boston Globe*, February 19, 2003.

17. Griscom Morgan became the director of Community Service, Inc., when his father retired in 1964. Griscom's wife, Jane, became director in 1970, holding that position until 1997. Both had an interest in intentional communities and CLTs, stemming in part from their personal involvement with an intentional community in Yellow Springs, called the Vale, which they helped to establish in the 1970s. The land underlying the Vale was conveyed to a local CLT in the mid-1980s, named the Community Service Land Trust.

18. At some point during this period they also visited the Celo community and contemplated living there. They decided not to do that, although one of their daughters later attended the Arthur Morgan School at Celo.

19. Taylor Branch, *Parting the Waters: America in the King Years, 1954–63* (New York: Simon & Schuster, 1988), 524–632.

20. The protesters were eventually released after staging a hunger strike that frightened the police into turning them loose. They immediately staged a celebratory parade, black and white activists dancing defiantly down Main Street.

21. Robert Swann, "Clarence Jordan and Koinonia Farm," in *Peace, Civil Rights, and the Search for Community*, chapter 17.

22. It is fair to say, in retrospect, that Koinonia Farm was the seedbed for two national movements. Both the community land trust and Habitat for Humanity can trace their origins to conversations at Koinonia in the mid-1960s. Until recently, these movements evolved along parallel tracks, with little interaction between them. By 2008, however, a pattern of local cooperation had become apparent to the national leaders of both movements, with over three dozen documented cases of local CLTs and local Habitat chapters joining forces to develop affordably priced housing for lower-income families. With their local affiliates pointing the way, the National CLT Network and Habitat for Humanity International signed a memorandum of understanding in 2009 to foster cross-training, technical support, and collaborative development between their constituencies.

23. ICE relocated again in 1980, moving west to Greenfield, Massachusetts. After ten years in Greenfield, it moved once more to Springfield, Massachusetts.

24. The National Sharecroppers Fund was a nonprofit advocacy organization created by the Southern Tenant Farmers' Union in 1937 to publicize the plight of sharecroppers and to push for legislation, social services, and economic opportunities to expand the rights and ease the lives of these impoverished farmers. Faye Bennett was executive director of the National Sharecroppers Fund from 1952 to 1974. She was 54 years old when Slater King came calling, asking for her support for the cooperative farm/leased-land community he had been discussing with Bob Swann.

25. The cooperative model they found most attractive was the *moshav shitufi*. This was different than a kibbutz, where farming is done collectively and profits are shared equally. In a moshav, purchasing and selling are done cooperatively, but each family has its own leasehold and owns its own home.

26. The team of people who had made the trip to Israel were joined on this planning committee by Father A. J. McKnight, James Mayes, Charles Prejean, James Wood, John Lewis, and William Peace. C. B. King provided legal advice throughout the planning process.

27. It was probably not a coincidence that chapter 8 in Arthur Morgan's book *The Small Community*, which had made such an impression on Swann in 1943 when he was in prison, was entitled "The Creation of New Communities."

28. A decade later, Father McKnight was appointed by President Jimmy Carter to the first board of directors of the National Cooperative Bank. He later served as vice president of the board, the same position he had held on the founding board of New Communities, Inc.

29. The story of the planning, founding, and first years of New Communities can be found in the following sources: *The Community Land Trust* (International Independence Institute, Cambridge, MA: Center for Community Economic Development, 1972), 16–25; Robert Swann, “New Communities: 5,000 Acres and \$1,000,000,” in *Peace, Civil Rights, and the Search for Community*, chapter 20; and an interview with Charles Sherrod, conducted by John Emmeus Davis in 1981, excerpts of which were published in *The Community Land Trust Handbook* (Emmaus, PA: Rodale Press, 1982), 39–47.

30. *The Community Land Trust Handbook*, 46.

31. New Communities provided an object lesson for later CLTs, among whom it became an article of faith that “Thou shall not encumber thy land with debt.” Even though the land was lost, New Communities, Inc., (NCI) did not dissolve. The corporation remained in existence. When black farmers in the South won a \$375 million settlement from the United States Department of Agriculture in 1999, resolving a class-action suit that had charged USDA with racial bias, NCI filed a claim, alleging that discriminatory lending at USDA in the 1970s and early 1980s had contributed to the failure of NCI’s agricultural business and the loss of its land. In the summer of 2009, after a decade of being rebuffed by USDA, NCI was awarded \$12 million. Its board began searching for farmland to buy in the Albany area, land that would be owned, this time around, debt free. The final chapter of NCI has yet to be written.

32. New Communities itself never managed to put in place most of the features of ownership and organization described in the book that was based on its story. In a valiant 15-year struggle to hold on to its land, the vision and plan put down on paper for this CLT “prototype” were never realized on the ground.

33. *The Community Land Trust*, 17.

34. *Ibid.*, 38.

35. At a seminar sponsored by the Lincoln Institute of Land Policy in 2004, Terry Mollner, who had served on ICE’s staff during the second half of the 1970s, tried to recall how ICE had arrived at the tripartite allocation of seats among leaseholders, nonleaseholder residents of the surrounding community, and representatives of the “public interest.” He could not. He expressed mild amusement that what had “seemed like a good idea at the time” had proven its worth over the years and become a fixture of the CLT model.

36. In Webster’s own words, “Bob would give me scribbled drafts and notes. I would have to organize them and polish them. He kept talking about ‘land trust’ this, ‘land trust’ that. I said we have to be able to distinguish it from other land trusts doing conservation. Why don’t we call it a *community* land trust? He liked the suggestion. That was probably my only contribution to the CLT movement.” Conversation with John Emmeus Davis, 2007.

37. Several rural land trusts were created in the early 1970s, most notably Earthbridge in Vermont and Sam Ely in Maine. The latter published a national newsletter, the *Maine Land Advocate*, for seven years (1973–1979).

38. To oversee this project, WCLT hired its first executive director, Mike Brown, with funds obtained by Marie Cirillo from the Catholic diocese in Nashville. Brown served as WCLT’s director from 1980 to 1984. He later joined the staff of ICE and went on to become a partner in a national consulting cooperative, Burlington Associates in Community Development, providing technical assistance to dozens of CLTs.

39. One of the Covenant CLT’s first leaseholders, incidentally, was Ellie Kastanopolous, who later became the executive director of Equity Trust. The story of the founding of the Covenant CLT is told in *The Community Land Trust Handbook*, 62–75.

40. In an interview conducted by John Emmeus Davis in 2008, Marjorie Swann attempted to describe the different abilities and contributions of Swann and Matthei in building the CLT movement: “Bob was very good at the theoretical stuff, at putting it into words. . . . He

was brilliant when it came to articulating the ideas and putting them into a whole plan. But he was not good at motivating people. Chuck's genius was in inspiring people to do it. After Chuck took over ICE, the land trusts multiplied."

41. For the next five years, as Matthei rebuilt ICE's staff, \$300 was the monthly salary earned by all of ICE's employees.

42. Matthei had earlier joined with Mitch Snyder, Perk Perkins, and other members of the Center for Creative Nonviolence and Sojourners in trying to establish a CLT in Washington, DC. The Columbia Heights Community Ownership Project was incorporated in 1976. Soon after gaining control of several inner-city properties, however, it moved on to other issues, leaving its CLT agenda behind. The community organizers at Sojourners decided that forming a CLT had been premature. They turned their energies toward developing a neighborhood tenants union, which battled condo conversions and promoted resident-owned housing cooperatives. It is fair to call the Community Land Cooperative of Cincinnati, therefore, the first urban CLT.

43. *The Community Land Trust*, 64. The text goes on to say, however, that the main goal of such procedures should be to "ensure that community-generated value increments accrue to the community and not to the individual." Responsibility for calculating and allocating such value was to be assigned to "a committee either named by the community or operating as part of the board of trustees."

44. *The Community Land Trust Handbook* was authored by Marie Cirillo, John Davis, Rob Eshman, Charles Geisler, Harvey Jacobs, Andrea Lepcio, Chuck Matthei, Perk Perkins, and Kirby White. It was illustrated with drawings and prints produced by Bonnie Acker and photographs taken by Kerry Mackin and Bob O'Keefe.

45. "Typically, the CLT retains a first option to buy the improvements at the owner's original invested cost, often adjusted for inflation, depreciation, and damage during the ownership period. . . . Thus, the first leaseholder is guaranteed equity in the improvements, and the succeeding leaseholder is able to buy the improvements at a fair price. No seller will profit from unearned increases in market value, and no buyer will be priced out of the market by such increases." *The Community Land Trust Handbook*, 18.

46. "While the CLT expects responsibility and a positive commitment from leaseholders, it also has a moral responsibility to them above and beyond the lease agreement, and a practical need to help them use their leaseholds appropriately and well. This is particularly true with low-income leaseholders, who have only limited access to credit and services that may be needed for such things as emergency repairs to their buildings." *Community Land Trust Handbook*, 215–216.

47. *The Community Land Trust Handbook*, 74.

48. Gandhi's concept of trusteeship is captured well in the following quote: "What belongs to me is the right to an honourable livelihood, no better than that enjoyed by millions of others. The rest of my wealth belongs to the community and must be used for the welfare of the community." M. K. Gandhi, *Trusteeship* (Ahmedabad, India: Navajivan Trust, 1960).

49. The three other "paths for action" proposed in the 1972 book's "Mandate for Action" were (1) having government "play the dominant role in financing and setting up a land trust"; (2) advocating for the stewardship of scarce natural resources placed in a land trust; and (3) convincing existing communes and intentional communities to "place their land under a common trust umbrella" organized on a regional basis.

50. Slater King's brother, C. B. King, had advised the planners of the first CLT to incorporate New Communities as a nonprofit corporation, not as a real estate trust. This practice has continued among CLTs to the present day. Although nearly every CLT is a nonprofit corporation, not all CLTs have secured—or even sought—a 501(c)(3) tax exemption. Most of

the early land trusts did not seek 501(c)(3) status. One that did, the Sam Ely Trust in Maine, had it stripped away because it was not operated in ways recognized by the Internal Revenue Service as “charitable.” The IRS objected specifically to the assistance Sam Ely was giving to farmers (i.e., private farm businesses). The revocation of its tax exemption precipitated the organization’s collapse.

51. The City of Boston later became both a supporter and a partner. The most dramatic evidence of such municipal support was the 1988 decision to grant DNI the power of eminent domain in the Dudley Triangle, aiding in the assembly of small, fragmented parcels of land into larger, developable sites for the neighborhood’s revitalization. See Peter Medoff and Holly Sklar, *Streets of Hope* (Boston: South End Press, 1994).

52. DNI was eventually to assemble, hold, and lease lands not only underneath limited-equity cooperatives, limited-equity condominiums, and rental housing, but also beneath urban parks, commercial greenhouses, a job training center, and a community center.

53. An earlier CLT had done so, as well. An extensive service area had been carved out by the Northern California CLT, cofounded in 1973 by Erick Hansch, who had moved west after six years on the staff of the International Independence Institute. It was not until the early 1990s that NCCLT reorganized to focus on housing and community development in the Bay Area, rather than purporting to serve all of northern California.

54. The San Juan Islands off the western coast of Washington proved to be an especially fertile area for the growth of CLTs. Lopez Island and Orcas Island gave rise to the Lopez CLT and OPAL (Of People and Land), both founded in 1989. In later years, CLTs were organized on San Juan Island, Waldron Island, and Lummi Island.

55. In March 2009, the National CLT Network reported the results of a national survey of its members, tallying the incidence of defaults and foreclosures in each CLT’s portfolio of resale-restricted, owner-occupied housing. At a time when over 7 percent of all residential mortgages in the United States were in default and 3.3 percent of all mortgages were in foreclosure, CLT homeowners were posting a default rate of 1.4 percent and a foreclosure rate of 0.5 percent ([www.cltnetwork.org](http://www.cltnetwork.org)).

56. The CLT’s success in preventing foreclosures has attracted attention not only in the public sector, but in the business sector, as well, especially among private lenders who have seen default and foreclosure rates soar since 2006. Where the mortgaging of resale-restricted homes on leased land was once seen as an exotic and risky loan, many lenders now regard the CLT as a credit enhancement.

57. Several other organizations gradually got into the game, proposing “model” documents and “best practices” of their own. The E. F. Schumacher Society, founded by Bob Swann and Susan Witt, developed model documents that were somewhat different than ICE’s, focusing on rural CLTs. In 1990, Chuck Matthei left ICE and founded Equity Trust. Its publications focused on the application of CLTs to agricultural lands, including partnerships between CLTs and CSA (community supported agriculture farms). Regional coalitions of CLTs emerged in the Pacific Northwest and in Minnesota in 1999 and 2003, respectively, each of them promoting standardized systems for operating a CLT and documenting its performance. In 2005, the Florida Housing Coalition established the Florida CLT Institute to promote CLT development in the Sunshine State. The next year, 2006, the National CLT Network established its own academy to research, develop, publish, and teach best practices for CLTs.

58. Although many attorneys lent their expertise to this project, David Abromowitz, a Boston attorney who had advised DSNI, served as the *Manual’s* principal legal advisor. Abromowitz must be given most of the credit for the model ground lease’s careful and equitable balancing of the interests of homeowner, landowner, and lender. The overall editor for both editions of the *CLT Legal Manual* was Kirby White.

59. Congressman Sanders had invited Tim McKenzie, director of the Burlington Community Land Trust (BCLT), to testify before his House Subcommittee in the spring of 1992. McKenzie's testimony about the BCLT's success in creating permanently affordable homes was well received, convincing Sanders that there might be an opening for some sort of federal legislation supportive of the CLT model, especially if it had no budgetary impact. When asked by Sanders for suggestions, McKenzie brought the City of Burlington's housing director, John E. Davis, into the conversation. After consulting ICE, McKenzie and Davis urged Sanders to propose a statutory definition of the CLT to make it easier for CLTs to receive federal funding and technical assistance under the HOME program. Sanders readily agreed but then discovered that he had only a few days to get something into the hopper. A one-page definition of the "community land trust" was drafted overnight by McKenzie and Davis, reviewed by ICE, and sent off to Sanders' office two days later. Their definition was inserted by Sanders into Section 212 of the Housing and Community Development Act of 1992 and approved by Congress with no changes (*Congressional Record—House*, October 5, 1992: H11966).

60. The CLT Academy was started as a joint venture of the National CLT Network and the Lincoln Institute of Land Policy. The cochairs of its founding board were Lisa Byers, the Network's president, and Roz Greenstein, representing the Lincoln Institute.

61. The editorial coordinators for *Community Economics*, over its entire 14-year run, were Kirby White and Lisa Berger.

62. An earlier conference had been hosted by ICE at Voluntown, Connecticut in 1983, but it could hardly be called a "national CLT conference" since only a few CLTs existed at the time and none was represented in Voluntown. This was more a gathering of community organizers, housing professionals, and ICE staff who were interested in starting CLTs. ICE always pointed to the 1987 conference in Atlanta, therefore, as the first national conference of CLTs.

63. ICE convened a total of nine national CLT conferences from 1997 to 2003. They were held in Atlanta (1987); Stony Point, New York (1988); Burlington, Vermont (1990); Cincinnati (1993); Washington, DC (1996); Durham, North Carolina (1997); Saint Paul, Minnesota (1999); Albuquerque (2000); and Syracuse (2003). The lead role in coordinating most of these conferences was played by Julie Orvis, who became the longest-serving member of ICE's staff (1987–2005).

64. Among the many white knights who rode to the rescue of the 2005 conference were Allison Handler and her staff at the Portland Community Land Trust, several leaders from the regional CLT coalitions that had started in the Pacific Northwest and Minnesota, several of the principals from Burlington Associates in Community Development, and Roz Greenstein from the Lincoln Institute of Land Policy. Drawing on Lincoln's resources, Greenstein provided critical financial and logistical support for the Portland conference. One year later, she helped to fund the National CLT Academy and then served for three years on the Academy's founding board.

65. The Network's board was drawn from every region of the United States. Regional representation was a factor in choosing the executive committee, as well. The Network's first president was Lisa Byers (OPAL CLT, Washington state); the vice president was Jim Mischler-Philbin (Northern Communities CLT, Minnesota); the secretary was Dannie Bolden (Gulf County CLT, Florida); and the treasurer was Dev Goetschius (Housing Land Trust of Sonoma County, California).

66. Following the Portland conference in 2005 and the Boulder conference in 2006, the first national conferences convened by the Network were held in Minneapolis (2007); Boston (2008); and Athens, Georgia (2009).

67. The Northwest CLT Coalition was established in 1999, the Minnesota CLT Coalition in 2000, and the Colorado CLT Coalition in 2008.

68. *The Community Land Trust Handbook*, 181.

69. Nearly all of the first CLTs counted pastors, priests, nuns, or former nuns among their founders and leaders. This certainly contributed to the faith that was regularly put in the miracle theory of financing. Perhaps it also accounted for the frequency with which such miracles seemed to occur.

70. *Community Economics*, no. 1 (Summer 1983): 3.

71. As ICE's revolving loan fund grew larger and more complex—and as ICE's technical assistance to community loan funds increased—staff other than Matthei played a larger and larger role. For over a dozen years, from 1981 to 1993, as ICE's revolving loan fund grew from \$45,000 to \$12 million, the fund's main manager was Sr. Louise Foisey. Other members of ICE who contributed the most to ICE's work with community investment over the years were Sr. Corinne Florek; Greg Ramm; Mary O'Hara; Raylene Clark-Gomes; and the former president of ICE's board, Michael Swack.

72. NACDLF joined with the National Federation of Community Development Credit Unions, several community development banks, and a number of other organizations in 1992 to create the Community Development Financial Institution Coalition, aimed at securing federal support for CDFIs. The coalition changed its name to the National Community Capital Association in 1996 and to the Opportunity Finance Network in 2006.

73. Toward the end of 1992, HUD's Department of Community Planning and Development distributed a circular (HUD 21B) to "All Regional Administrators, All Field Office Managers, All Regional Directors for CPD, All CPD Division Directors, All HOME Coordinators, and All HOME Participating Jurisdictions," declaring that "HOME funds may be used by CLTs. CLTs may also receive HOME funds for administrative and technical assistance for operating assistance and organizational support." The circular went on to say, "Community land trusts are, perhaps, one of the most effective means of ensuring permanent affordability of resident ownership simply because the trust maintains ownership of the land."

74. In addition to providing a definition of the CLT, Section 212 of the Housing and Community Development Act of 1992 bestowed three benefits on CLTs that were unavailable to other nonprofit housing developers. A CLT could receive CHDO designation and HOME funding even if it did not yet have a "demonstrated capacity for carrying out activities assisted with HOME funds" or was unable to "show one year of serving the community." Furthermore, it said, "Organizational support, technical assistance, education, training, and community support under this subsection may be available to . . . community groups for the establishment of community land trusts." This opened the door for federal assistance to CLTs that were just getting under way.

75. Some assistance was provided by ICE's own staff, principally Jeff Yegian, who was based in Boulder, Colorado. Most of the on-site technical assistance offered to CLTs from 1994 to 2004, however, under ICE's TA contracts with HUD, was provided by Burlington Associates in Community Development. After HUD—and ICE—withdrawed from the field, the partners in this national consulting cooperative continued to assist new and mature CLTs. By 2010, over 90 CLTs had received some degree of direct TA from Burlington Associates. Many others had benefited indirectly by having access to educational documents and technical materials posted on the Burlington Associates web site and freely shared with the public under terms of the Creative Commons.

76. Fannie Mae released a model lease rider for CLTs in 2001. As part of the same package, Fannie Mae also published *Guidelines on the Valuation of a Property Subject to a Leasehold Interest and/or Community Land Trust*. This document provided assistance to lenders and appraisers in valuing CLT transactions.

77. John Emmeus Davis and Rick Jacobus have documented a diverse array of municipal support for CLTs, including seed money for planning a CLT; donations of city-owned property, grants of municipally controlled funds, and low-interest loans for developing CLT projects; capacity grants for sustaining CLT operations; and equitable assessments in valuing and taxing a CLT's resale-restricted homes. See Davis and Jacobus, *The City-CLT Partnership* (Cambridge, MA: Lincoln Institute of Land Policy, 2008).

78. This analogy is evocative but not exact, since a hybrid in the breeding of plants is a one-generation phenomenon. Hybrids cannot breed true. The mixing of traditions and agendas in the CLT, by contrast, has produced a model that can be reproduced across many generations.

79. These are the Diamond State CLT in Delaware and the Community Housing Land Trust of Rhode Island.

80. This was one of Bob Swann's abiding concerns about the movement he had helped to found: "Creating perpetually affordable housing is a good idea. The only thing is that there is a danger of losing track of the land itself." See the interview of Bob Swann conducted by Kirby White for *Community Economics*, no. 25 (Summer 1992): 3-5.

81. Davis and Jacobus offered a similar argument in *The City-CLT Partnership*: "The role of steward draws the CLT back to its original mission of shepherding resources that a community invests and of capturing values that a community creates. Making stewardship its principal activity brings the model full circle, refocusing the CLT on what it does best" (38).

82. It is not only in communities of color that CLTs are being organized to protect lands, promote development, and preserve the identity of place-based communities. It is there, however, that market forces and public policies tend to take the greatest toll, especially in African American communities proximate to an expanding downtown or situated on the shoreline of a river, lake, or ocean. Recognizing the special needs of these communities and responding to the rising demand for CLT assistance from African American communities in the South, the National CLT Network launched a Heritage Lands Initiative in 2008.

## Chapter 2

# Initial Choices

This chapter looks at a set of interrelated questions that the organizers of a CLT must address early in the organizing process. These questions include: who should plan and launch the organization; whom will the organization serve; in what geographical area will it operate; what kind of program will it mount; what other organizations will it relate to; where will it find the resources to support its program; and finally who should control this organization?

### **Who Should Plan and Launch the CLT?**

For those actively engaged in planning the creation of a CLT, the question of who should undertake this action may seem already to have been answered. Nonetheless, it can be important to raise the question of who *else* should be invited to join the “CLT organizing committee” – and who else should stand behind the CLT as it is launched. Community land trust programs have been launched by a variety of institutions and groups – including faith-based groups, community organizing programs, existing housing and community development organizations, and local government agencies. Creation of CLTs has also been spurred by a variety of individuals, who may or may not be associated with the groups mentioned here, but who bring the kind of energy and commitment that is likely to be an important part of what makes a CLT happen.

**The importance of involving established community development players.** If the initial effort to create a CLT is coming from grassroots sources such as local religious congregations or community organizing programs, it is advisable to look for participation as well from local government agencies and existing housing and community development organizations that are already engaged in work related to what the CLT expects to do, and that are likely to control the resources to which the CLT will need access.

Some CLTs – and in particular some early CLTs – were created through strong community-based initiatives but lacked the participation of established nonprofit and public sector players. Often these CLTs struggled to gain access to the funding and other resources they needed to accomplish their goals. Even if the local “community development establishment” is skeptical about the CLT model, it is best to try to involve and persuade people from this quarter. Even if it is not the most experienced and influential people in those agencies who are interested in participating, those who do participate can provide important information about what resources are available and what kinds of housing and community development work is being done by others. They can also play an important role in introducing the CLT initiative to established players in the field. Obviously CLT organizers should not go into the field without knowing who is already there, and should not take those who are there by surprise.

How then do you find those who can guide you? Not all communities have the same kinds of housing and community development infrastructure. Public agencies and departments may be variously named, organized, and combined, but look for the people and/or agencies that:

- administer Community Development Block Grant (CDBG) and HOME program funds in jurisdictions that are entitled to receive such block grants directly from the federal government (in smaller, “non-entitlement” communities, look for those who develop local proposals for block grant funding administered by the state);
- manage affordable home purchase and home repair financing programs;
- conduct professional land-use planning activities for municipal and county governments;
- manage public housing (within municipal housing authorities);
- manage affordable housing development programs, including municipally controlled nonprofit developers;
- manage tax-foreclosed real estate for municipal or county governments;
- in rural areas, manage Rural Development housing programs within the US Department of Agriculture;
- carry out any other public sector programs relating to housing and community development.

Among local not-for-profits, look for those that:

- develop affordable housing (new construction and/or rehabilitation);
- manage affordable rental housing;
- operate neighborhood improvement programs;
- provide training and counseling for prospective lower income homebuyers;
- provide credit counseling;
- provide counseling and other assistance to tenants;
- operate weatherization and energy efficiency programs;
- provide housing-related legal services to lower income people and nonprofits;
- provide loans and other financial services for lower income people and nonprofits;
- provide architectural services to lower income people and nonprofits.

In seeking out such people and agencies, you will not only find people who can bring useful experience, skills and resources to the CLT effort; you will also gain important knowledge about what is already being done in your community, who is doing it, and how it is being done.

**The importance of involving people from outside established programs.** If the initial efforts to create a CLT program have come from within the established housing and community development programs, it may be important to look also for people who are *not* housing and community development professionals. Such people may include the following:

- *Potential lower income homebuyers*, who know what kind of homes they want and what prevents them from acquiring them.
- *Clergy*, who are often sympathetic to the idea of stewardship and the CLT model, and who know the needs and talents of their congregations.
- *Active neighborhood association members*, who know the needs of their neighborhoods and are interested in ways to address those needs.
- *Employers*, for whom high local housing costs can restrict the pool of available labor and/or increase the cost of labor.
- *Bankers*, who know what it takes to qualify for home mortgage financing and what problems are faced by people trying to find a home they can afford to finance.
- *Realtors*, who know the local housing market and how it affects potential buyers (some realtors may resist the idea but others may be intrigued by the CLT approach).
- *Lawyers*, who deal with real estate and understand property issues (often there are lawyers, too, who are intrigued by the CLT approach).
- *Anyone else* who is intrigued by the CLT approach.

### **What Area to Serve?**

The geographical areas served by CLTs range from single urban neighborhoods, to whole cities or counties, to multi-county regions and entire small states. The typical size of CLT target areas has increased over the years. In fact it is now common to find that CLTs originally established as neighborhood-based organizations have expanded their territories to include whole cities, and sometimes surrounding suburbs as well.

This trend toward greater geographical scale is obviously driven by a concern with capturing the efficiencies of scale. In some cases, too, it may be the result of one organization expanding to fill a vacuum left by the failure or weakness of a small neighboring organization. And in many cases it has been a trend encouraged by funders, which find it more efficient to work with a limited number of larger organizations than with a large number of smaller ones.

There are trade-offs, however. As the size of the territory increases, the word *community* in the CLT's name tends to fade into abstraction (and in some cases has actually been removed altogether from the organization's legal name). The organization tends to become – and to be perceived as – an extension of public policy, albeit a progressive policy. It may be effective in this role, but it will not command the kind of loyalty from residents of the area that a true community organization can command. As the size of the territory increases it also becomes more difficult to oversee the organization's program from a base in a single location, which may result in a loss of efficiency as more time must be spent in travel, and certain kinds of tasks – especially those involving interaction between CLT staff and the residents of CLT homes – will happen less often. As a result, CLT staff in an extensive service area

will be more likely to be seen by most residents of CLT homes as strangers from out of town.

How to weigh the relative advantages of greater geographical scale vs. tightly localized scale will depend in part on whom the CLT is intended to serve and how it intends to serve them.

### **Who Will Be Served, Where, and How**

The *who*, the *where*, and the *how* are closely related aspects of a CLT's mission. Low income tenants living in deteriorated housing in disinvested neighborhoods have needs different from moderate income people who live in better housing and are more mobile but are still unable to afford homeownership. And these differing situations call for differing CLT programs.

**Working in low-income neighborhoods.** If a necessary part of the CLT's mission is to help low-income households, the CLT planners may choose to focus on creating better housing for these households in the neighborhood that they already call home. If most of these households are not able to qualify for mortgage financing – or for enough financing to afford even a deeply subsidized home – then the CLT's goals may include providing better and more affordable rental housing in that neighborhood.

However, many if not most CLTs have been founded with a basic mission of creating opportunities for low-income people to move *out of* tenancy and attain the benefits of ownership. Since the urban neighborhoods where low-income people are concentrated tend to be characterized by disinvestment, absentee-ownership, deteriorated housing, inadequate services, limited economic opportunities, and the social problems that these conditions engender, CLTs that set out to create permanently affordable homeownership opportunities for low-income people in these neighborhoods face a daunting combination of challenges. They not only must deal with the economic circumstances that make it difficult or impossible for a low-income family to qualify for the mortgage financing that will open the door to ownership; they must also deal with the surrounding economic circumstances that discourage owner-occupancy in general. Such a CLT may purchase and rehabilitate houses and arrange for financing that will allow them to be purchased on affordable terms, but it will be hard to sell those houses – and perhaps harder still to keep them owner-occupied over time – if other properties on the same blocks are deteriorated, abandoned, and boarded up.

Our intention here is not to discourage CLT planners from launching affordable homeownership programs in low-income neighborhoods. Our intent is only to emphasize that it is usually impossible for a CLT that chooses to work in such a neighborhood to be *only* a housing organization. If it wants to be a successful long-term steward of affordable housing in such a community it will almost certainly need to launch – or at least participate in – a broader neighborhood improvement effort that will address the full range of problems that affect the community. In this role it may, for instance, become involved in community organizing; it may lobby local

government for more services, better law enforcement, better enforcement of rental housing codes; it may become involved in efforts to support small business development and create jobs. And it may also become involved in managing a certain amount of rental property.

A number of CLTs working to promote homeownership in low-income communities have launched lease-purchase programs as a way of providing a bridge to homeownership for families that do not initially have the resources to make even very modest down payments and/or do not yet qualify for the necessary mortgages. These programs can make a decisive difference for some families, but the CLT must be prepared to accept the responsibility for property management for a period of one to three years – and perhaps longer if a family fails to achieve ownership in the designated period of time.

Another complicating factor in such neighborhoods is that the existing housing stock, though it may include some single-family homes, often also includes many two-to-four-family buildings. If the CLT wants to deal with these buildings – and if it wants to affect the overall condition of housing in the neighborhood it may have no choice but to deal with them – it will need to decide on an a workable approach to their ownership. Some early CLTs began with the idea that they would organize limited-equity housing co-ops to own these buildings. Even under the best of circumstances, however, organizing successful limited equity coops is a challenging undertaking. And to organize and *sustain* cooperative ownership of two-to-four-family buildings (each involving only two to four member families) has usually proven impossible. CLTs are thus left with two possible ways of dealing with these buildings.

One approach has been to sell such buildings to one owner-occupant who then rents the additional unit(s) to others, usually with some guidance from the CLT. This arrangement can work well when there is an appropriate combination of tenant and owner. For instance it can be an ideal arrangement for an elderly tenant with a need for occasional assistance in maintaining her home. Nonetheless it is a kind of arrangement that will require the CLT not only to help first-time homebuyers to succeed as homeowners but to help them succeed as landlords as well – which is no easy task.

The other possible approach to these multi-family buildings is for the CLT to decide that it will need to manage a certain amount of rental property itself and must commit the necessary time and resources to doing it well. Unfortunately, the per-unit cost of property management is high for an organization that is managing only a few – or a few dozen – units. The CLT can hope to find a professional property manager that will contract to manage scattered, relatively small properties, but it will be difficult, if not impossible, to find a professional manager prepared to do this in a low income neighborhood for a fee that will be cost-effective for the CLT.

**Working city-wide or regionally.** If a CLT's primary goal is to expand the supply of homeownership opportunities that are affordable for low and moderate income

people throughout a larger area, it will be less concerned with changing the character of a particular neighborhood and will therefore have much less reason to concentrate its efforts in a particular neighborhood. In fact it may want to avoid limiting its territory in a way that would prevent it from taking advantage of opportunities for cost-effective projects wherever it finds those opportunities. The size of its territory is likely to be influenced more strongly by a concern with how large a service area it can serve effectively from a single base of operations. Such a CLT may also be concerned with the question of what area its primary funder(s) would like it to serve.

It is possible for a CLT to define and implement two different kinds of programs – one focused on a neighborhood with particular needs, the other allowing for housing projects where opportunities present themselves throughout a larger area – but in planning such a dual program, an organization obviously needs to ask itself whether it really has the resources to do both things effectively. If it does have or can acquire the resources needed to do both, it may be strong enough to do certain kinds of things for a low-income neighborhood better than the smaller, purely neighborhood-based organization can – for instance providing appropriate, cost-effective management of rental housing.

The matrix below summarizes the kinds of relationships between program goals and service areas that may shape a CLT's plans. Needless to say, these relationships are not a matter of hard and fast rules. Many other factors will of course affect the CLT's plans, but it is still useful to think about how different kinds of service areas may affect program goals. (Regarding these relationships see also Chapter 18, Project Planning and Pricing.)

	<b>Low-income neighborhood</b>	<b>City-wide</b>	<b>Suburban</b>
<b>Improve low income rental housing</b>	Probably a CLT goal	Not necessarily a CLT goal	Probably not a CLT goal
<b>Create low income homeownership opportunities</b>	Probably a CLT goal	Probably a CLT goal	Maybe not a realistic goal
<b>Increase supply of affordable homes for median income homebuyers</b>	Maybe not a realistic goal	Possible CLT goal	Possible CLT goal
<b>Improve distressed neighborhoods</b>	Necessarily a CLT goal	Probably not more than one	Probably not a CLT goal
<b>Promote diverse neighborhoods</b>	Maybe not a realistic goal	A probable CLT goal	A possible CLT goal

## How Will the CLT Relate to Other Organizations

As noted above in connection with the composition of an organizing committee, one of the first things that CLT planners must do is to determine what is already being done by existing organizations and agencies. If what an existing organization is already doing in a CLT's designated territory relates to the CLT's goals in some way, then it obviously makes sense to explore a possible partnership with that organization rather than creating a redundant program.

The community land trust model is first and foremost a model of long-term stewardship. Most CLTs, of necessity, do a range of things that are not in themselves matters of long-term stewardship – including the development and redevelopment of housing, homebuyer counseling, and the marketing of homes, among other things. However a CLT need not perform such functions in every situation when a partner organization is positioned to do them effectively.

Most CLTs do a certain amount of *housing development* work, but there are some that do no development at all, and a number of CLTs, in addition to their own development work, perform stewardship functions relating to owner-occupied homes initially made affordable by others – including homes built by CDCs, Habitat for Humanity chapters and other nonprofits, and privately developed homes made affordable through inclusionary zoning programs.

Most CLTs provide some form of homebuyer *counseling and training* for those interested in buying CLT homes (and sometimes for those buying other homes as well), but many CLTs make use of programs offered by other nonprofit or public agencies – with the CLT then providing only counseling and orientation directly related to the unique features of CLT ownership. Some CLTs also refer their homeowners to post-purchase homeowner training and assistance programs operated by others.

Most CLTs are involved in *marketing* homes when the homes are new or have just come into the CLT's system, but marketing tasks can also be performed or shared by other entities, including other nonprofit developers, homebuyer counseling programs, and, in some cases, realtors. Some CLTs operate “buyer-initiated” programs, whereby the CLT subsidizes homes selected by buyers from among the properties listed for sale by conventional realtors, with the CLT then taking title to the land and executing a ground lease with the buyer. When CLT homeowners want to *resell* their homes, marketing efforts may be shared to a greater or lesser extent between the CLT and the homeowners themselves – with some CLTs controlling the process to a great extent and others leaving greater responsibility and control in the hands of the homeowners.

As noted above, CLTs engaged in neighborhood improvement efforts in distressed neighborhoods will want to cooperate actively with all other programs and institutions that are working to address the range of problems facing the community – including religious institutions and of course local government and its various agencies.

In any case, all CLT programs will inevitably be shaped by the types of partnerships that they are able to forge with others. Often the size and shape of the CLT's service area is also affected by the service areas of its partners.

### **Who Should Control the CLT – Through What Corporate Structure**

The question of who should control a CLT involves many of the same considerations mentioned at the beginning of this chapter in connection with the question of who should participate in the initial planning of a CLT. If there is any generally applicable answer to this question it is that those who control the organizations should include both people who have a first-hand knowledge of the community's needs (and are recognized by the community as having this knowledge) and people who have the technical knowledge and skills required to address those needs effectively. However, this answer does not apply in the same way to all of the various kinds of programs and service areas discussed above.

For a CLT program focused on addressing the multiple needs of a particular low-income neighborhood, the involvement of people who live in that neighborhood is a necessary priority – and the more of them who are involved the better. The kind of democratic, membership-based governance structure characterized by the “classic” CLT structure, described below, is strongly recommended for this type of situation. However, for a CLT that serves a larger area, with a focus primarily, if not exclusively, on expanding the area's long-term supply of homeownership opportunities for low and moderate income people, other types of governance structure may be considered.

**Classic CLT structure.** The “classic” CLT model is designed to balance the interests of individual CLT homeowners with the interests of the community as a whole. It entails an independent, community-based membership corporation in which there is specific provision for two equally empowered membership categories – one category including all people who live on CLT-owned land, the other category open to all other people in the community who have an interest in the CLT's efforts and want to support them. Each of these categories elects one third of the board of directors. The final third, the “public representatives,” may be elected by the total membership or by the board itself to represent the “broader public interest.” The bylaws of some but not all classic CLTs specify that the public representatives (or a certain number of them) are to be public officials. The details of the classic CLT governance structure are laid out in the Model Classic CLT Bylaws presented in Chapter 5-A, and are discussed in the Commentary on these Model Bylaws presented in Chapter 5-B. It is also this classic CLT model that is defined in the federal Housing and Community Development Act of 1992.

The rationale for this structure is based on the recognition that all CLT residents have a common interest in the organization that owns the land they live on and should therefore have a degree of control over that organization, but that, unlike such common interest organizations as co-ops and condominiums, CLTs are not limited to single properties that exist as “islands” in the larger community. The CLT's land

holdings are normally intermingled with other properties in the community and the number of holdings typically continues to grow – so that other individual property owners, and the community as a whole, are affected by the CLT’s actions and should have a right to become members of the organization and have a role in electing its board.

Especially for CLTs that wish to address a range of concerns in a low-income neighborhood or other relatively concentrated geographical community, the classic model provides a governance structure in which that full range of concerns can be expressed. The classic CLT is also likely to be recognized as “belonging to the community” in a way that a regional housing organization, for instance, often is not. This sort of community recognition may not be important if an organization is simply going to come into the community, build or rehab some homes, sell them, and leave. But, if an organization is going to have the multiple functions and long-term presence in the community that a CLT has, the community’s recognition and loyalty become very important indeed.

It must be recognized, however, that successful implementation of the classic governance structure requires some extra effort. The structure is likely to be relatively meaningless without an active outreach and organizing effort. Nonresident members must be recruited and encouraged to participate. All members must be encouraged to attend membership meetings, and the meetings must offer something meaningful to the members who do attend. All of these activities will obviously make demands on CLT personnel, which will in turn make demands on CLT resources. If CLT planners are not prepared – or are not able – to commit the resources needed to make the classic structure achieve what it is intended to achieve, then they should perhaps consider modifying that structure or opting for a different approach.

**CLT as program of existing organization.** If an existing housing organization is developing or wants to develop affordable homes for owner-occupants and wants a mechanism to preserve the affordability of those homes from one owner-occupant to the next, it may simply create its own “community land trust program.” Such an arrangement obviously has the advantage that it can be launched quickly and relatively inexpensively. There will be no need to create a new corporation, no need to submit a new application for tax-exemption, no need to do all the things that must be done in getting a separate not-for-profit entity up and running. It can also be argued that such a program, housed and staffed within an existing not-for-profit organization and sharing its costs with the organization’s other programs, will be the most cost-effective means of preserving the affordability of owner-occupied homes.

Nonetheless, even if the program’s *only* goal is to preserve the affordability of those homes – for 99 years and beyond – there are ways in which this type of program may eventually falter. The parent organization may be strong now and its current personnel may be strongly committed to the CLT program, but such organizations typically are not membership organizations; they are typically created

with bylaws that give the board of directors a relatively free rein to take advantage of whatever community development opportunities present themselves, and that typically do not spell out long-term stewardship responsibilities (as classic CLT bylaws do). Within such a structure there can be no real assurance that future boards of directors will see the CLT program as a high priority. They may not staff it adequately. They may choose to put the organization's resources elsewhere.

The disadvantages of this structure grow stronger if the program's mission is intended to go beyond seeing that homes are resold to eligible buyers for duly restricted prices. If the stewardship mission includes working with homeowners to preserve the physical quality, as well as the affordability, of the homes (as it should), and if it includes seeing that the homeowners are able to manage their finances, avoid predatory lenders and retain secure ownership of their homes (as it also should), then the CLT program must have the resources and the commitment to engage with its homeowners on an ongoing basis. If the resources are allocated elsewhere and the commitment is not there, the program will have limited success at best.

**CLT corporation established by existing nonprofit.** An existing housing organization that takes the lead in creating a CLT program may decide that the CLT should be separately incorporated but may still want to retain some degree of control over it. Like the organization that creates a CLT program within its own corporate structure, it may be interested in the CLT primarily as a means of preserving the affordability of owner-occupied homes developed through its own efforts, but, unlike that organization, it may not want the direct responsibility of owning the land beneath those homes. It may be prepared to house and staff the CLT's operation, and may want enough control over that operation so that it can coordinate the work of the CLT with its own housing development work. Given this interest in controlling the program, it will probably not want to establish a classic CLT structure – and perhaps not any governance structure in which a board of directors is elected by a broader membership.

In this case, the CLT corporation may be created with a board of directors that is wholly or partially appointed by the “parent” organization. There may or may not be provision for a certain number of “lessee representatives” on the board, and such representatives may or may not be appointed by the parent board, but if the parent wants to be sure of controlling the CLT it will create a structure in which it can appoint at least a majority of the CLT's board members. This arrangement may be an efficient way of preserving the affordability of owner-occupied homes, but it may not provide the most dependable basis for long-term stewardship – particularly for those stewardship functions that call for greater engagement with those homeowners over time and that will therefore require greater staff support.

In some cases however, the parent organization may itself be a membership organization with a broad base of membership in the community and with a board of directors elected by those members. It can be argued that there is no need to create a separate membership structure for a CLT created by such a membership-based parent,

and that to overlay one membership structure upon another in such a situation would tend to result in confusion and inefficiency. Nonetheless, if the parent organization is a mover and shaker in the community, organizing residents to support this development project and oppose that project, and thus focused on making things happen in the here and now, it may not be the best base for a patient, long-term stewardship program. In any case, the parent's membership structure is not likely to give CLT lessee-homeowners the kind of representation that a classic CLT does.

Finally, we should emphasize that there are many different degrees of control that a parent organization may exert over a subsidiary. It is not simply a question of controlling or not controlling the new organization. The parent may, for instance, support the creation of a classic CLT structure in which it controls one or a few board seats – perhaps as designated “public representative” seats – but in which it does not control a majority of the board seats. It is also possible to establish a new CLT corporation with bylaws that provide for diminishing control of the board by a parent organization over time. Several “parents of CLTs” have in fact done this – with the number of board seats controlled by the parent reduced from year to year.

**CLT corporation established by government.** It has become increasingly common for local governments to take the lead in establishing CLTs. As with CLTs established through the initiative of existing nonprofit housing organizations, the degree of control exerted by the government entity varies greatly.

Some local governments, while creating a CLT as a separate corporation, have retained full control of the organization, appointing most or all of the board members, and staffing and housing the program within its own offices, so that it is a direct extension of the government's own program. Some government officials believe that if government is going to put public resources into a CLT program it should control the program to ensure that the resources are used responsibly and effectively. And from the CLT's point of view, this kind of seamless relationship with a primary source of funding – both to subsidize homeownership units and to support the CLT's operations – means that the program will not have to struggle from year to year to acquire the resources necessary for its work (unless the government's priorities change).

In other cases, local governments that have used their resources and powers to encourage the development of a CLT have wanted the CLT to be a fully independent organization. In their view, an independent nonprofit organization – more or less insulated from political motivation and buffered against the potentially destabilizing effects of electoral politics – is better positioned to carry out a CLT program consistently over an extended period of time, at least if there is reason to think that it can maintain a strong working relationship with its local government. (One interesting form of CLT-government relationship is the model implemented in Syracuse, New York, where an independent CLT and the municipality share control of a second nonprofit that utilizes municipal resources to develop homes for the CLT,

while the CLT focuses on various neighborhood improvement activities as well as its long-term relationship with its homeowners.)

In any case, as with relationships between CLTs and established housing organizations, there are trade-offs to be considered between immediate access to financial and technical support on the one hand and the kind of independence that makes it possible to chart its own long-term course, play an activist role in the community, and back up its long-term promises to its constituents.

## Chapter 3

# Incorporation and Basic Structural Considerations

This chapter reviews the structural issues to be addressed in establishing a CLT as an independent not-for-profit corporation. For the most part, these are issues that must be addressed whether the organization is to have the structure of a “classic” CLT or one of the variations described in the previous chapter on “initial choices” – though we will note some concerns that are specific to the classic model. For a full treatment of all relevant issues, this chapter should be read in combination with the chapters dealing with bylaws and tax-exemption as well as the chapter on initial choices.

### The Basic Structure

**The nature of not-for-profit corporations.** Like the for-profit corporation, the not-for-profit (often called “nonprofit”) corporation is a legal entity, chartered under state law, with the power to act as though it were, in some respects, an individual. It can enter into contracts, own property, borrow and lend money, bring suit in a court of law (and be sued). The not-for-profit corporation is also like the for-profit corporation in the ways that liability is limited for those associated with the corporation. The staff, the board, and the members of the corporation are not protected from liability for their own actions, but in most circumstances they need not worry about being held liable for the acts of others merely because they are associated with the corporation.

However, for-profit and not-for-profit corporations differ fundamentally in the ways they are owned and controlled. A for-profit corporation is owned and controlled by those who own shares of stock issued by the corporation, with the degree of control usually apportioned according to the number of shares owned by each. Any profit generated by the for-profit corporation belongs ultimately to the stockholders, and it, too, is apportioned on a per-share basis. In the event of dissolution, the net assets of the for-profit corporation are distributed to the stockholders, again on a per-share basis.

Not-for-profit corporations are controlled ultimately not by stockholders but by *members*. The membership may be large and open to any who wish to join, or it may be limited in various ways. Sometimes it is limited to just the members of the board of directors. Those nonprofits whose membership is not limited to the board of directors are commonly called “membership organizations.” The classic CLT model calls for a not-for-profit corporation structured as a membership organization, with membership open both to those who lease land from the CLT and to other members of the community.

CLT corporations are normally structured in such a way that earnings and assets cannot be distributed to the members. State laws restrict a not-for-profit corporation’s right to distribute assets to members, and any such corporation may, in its articles of incorporation, prohibit such distributions absolutely. If an organization is to qualify for federal 501(c)(3) tax-exempt status, its articles must stipulate that “no part of the net earnings of the Corporation shall inure to the benefit of any individual” (except as compensation for services rendered or in furtherance of its charitable purposes), and that, in the event of dissolution, the corporation’s net assets can be distributed only to another exempt organization or only in accordance with the exempt purposes of the dissolving corporation. Even if a CLT does not intend to qualify for 501(c)(3) tax-exemption (though most do), its articles should still prohibit the inurement

of earnings to individuals and should require that, in the event of dissolution, the corporate net assets be distributed only in accordance with the CLT's corporate purposes.

**Basic organizational documents.** In establishing a CLT as a not-for-profit corporation with appropriate tax-exempt status, there are three basic steps. The formal actions involved in these steps must be taken in the order in which they are listed below. However the issues that will be confronted in drafting the several documents are closely related in a number of ways, so it is important to address the entire set of issues before taking any formal action.

1. *Draft and file articles of incorporation.* The legal identity of the corporation under the laws of your state is established by filing “articles of incorporation” (known by other names in certain states) with the Secretary of State – which in practice usually means filing with the corporations office within the Department of State.
2. *Draft and adopt bylaws.* The bylaws, establishing working rules for the corporation, are adopted by the membership and/or board of directors once the corporation has been established through the filing of articles. The bylaws are a binding legal document, but they are established internally and do not need to be filed with a government agency in the process of creating the corporation (though various agencies, including the IRS, may require that they be submitted in connection with subsequent processes).
3. (In most cases) *prepare and submit application for federal tax-exemption.* This application is submitted to the Internal Revenue Service, which normally takes several months to determine whether the organization qualifies for exemption. Separate applications for exemption from state taxes – including possible exemption from sales taxes – may then be filed. The new corporation may also need to register with certain state agencies as a charitable organization, depending on state law.

Articles and bylaws must be consistent with each other. Most of what is stipulated in the articles is more general than what is stipulated in the bylaws, which are concerned with the details of governance. However there will be a certain amount of overlap between the two documents. It is wise to work out the detailed provisions of the bylaws before preparing a final draft of the articles for filing.

Both the articles and the bylaws must be submitted to the IRS with the application for tax-exemption. In reviewing the application, the IRS will look carefully at the articles to determine whether the corporation's purposes qualify as “exempt purposes” and whether the corporation's powers are limited in the ways required for exemption. The bylaws will be examined to determine whether they are consistent both with the articles and with the requirements for exemption. For these reasons, it is important to address the questions relating to tax-exemption before filing articles of incorporation and adopting bylaws. See Chapter 6, “Tax Exemption,” for a detailed discussion of federal tax-exemption issues.

**Process for Drafting articles and bylaws.** It is usually possible for a small group of people to organize a not-for-profit corporation rather quickly using conventional models for the basic organizing documents. Sometimes the organizers will simply copy the documents of a similar organization, changing names and dates but otherwise raising few questions about the appropriateness of the models. We strongly recommend that this approach *not* be taken in organizing a CLT. We also strongly recommend that the matter of incorporation not simply be turned over to an attorney to be carried out without participation from others. Though the results of such action will no doubt be legally correct, the process of thinking through the

structure of the new organization should not be short-circuited. The process should be seen as an opportunity for the organizers of the CLT to discuss and agree upon the purposes of the new organization and the ways in which the organization will be structured and controlled to achieve these purposes. The process should clarify and *internalize*, within the group, the shared principles that are set down in black and white in the organizing documents.

### **Considerations in Preparing Articles of Incorporation**

The articles of incorporation (perhaps known by another term in your state) describe and establish the basic legal identity of the corporation. Your CLT will *become* a corporation when its articles are duly filed in your state's Department of State.

The information contained in the articles normally includes the legal name of the corporation, its purposes and powers, the location of its principal office, and the names of those who will have the power to act for the corporation as directors until a permanent board of directors is duly elected. Additional specific information may be required by the law of your state. The articles may also contain a variety of stipulations relating to the membership, the board of directors, and other matters.

The preparation and filing of articles is not a difficult legal process, but this fact does not mean that it should be treated casually. The goal should not be simply to "get incorporated" as soon as possible, but to establish the legal structure that will best embody and serve the purposes of the CLT. The process should be guided by an attorney or other person who is familiar with the not-for-profit corporation law of your state and the IRS requirements for 501(c)(3) tax-exempt status, but the organizers of a CLT should participate in deciding the basic questions of purpose and structure that are involved in drafting the articles. In preparing articles of incorporation a CLT will have the following major areas of concern.

- What is required by the not-for-profit corporation law in your state (and what regulations have been established by your Secretary of State)?
- What is required by the IRS if the new corporation is to qualify for tax-exempt status?
- What is the best way to establish and preserve the essential features of the CLT model? (What will enable the new CLT to work as the CLT model is designed to work and to prevent it from working otherwise?)

**State requirements.** Though they are generally similar, laws pertaining to not-for-profit corporations do vary somewhat from state to state. If you are not already familiar with your state's not-for-profit corporation law and filing procedures, you should consult with an attorney who is familiar with these matters, and/or look for the necessary information on line. It should be possible to find your state's not-for-profit corporation law on the internet, and your Department of State should have a web site that will provide basic information about filing articles of incorporation. Some of the basic points that you should check as you review the law are discussed below.

*Corporate name.* Every corporation must have a name that distinguishes it from all other corporations in the state. If you have reason to think that the name you want may already be in use, you can ask the Department of State (or the corporations bureau within the department) to search its records to determine the availability of the name before you present your proposed articles for filing.

The law may also impose other requirements or restrictions on corporate names. You may or may not be required to use some form or abbreviation of the words *Corporation*,

*Incorporated, or Limited in the name.* Certain words may also be prohibited. In some states, the word *Trust* may be used only in the names of corporations organized and regulated as financial institutions. In other states (e.g., New York) the word *trust* may be used only with the consent of the State Banking Department. (In the case of New York, consent has generally been given, but the process has sometimes been time-consuming, and some CLT organizers have chosen to adopt names that do not include the word *trust* for this reason.) In any case, check your not-for-profit corporation law for a list of prohibited or restricted words.

*Type of corporation.* The law may define different types of not-for-profit corporation with different purposes. Where this is the case, the articles should state the type of corporation that is being established. For CLTs – at least those that will seek tax-exempt status – the appropriate type is normally that defined as having charitable purposes.

*Corporate purposes.* The statement of corporate purpose included in the articles will of course be determined first by the actual purposes of the CLT, and secondly by the definition of “exempt purposes” recognized by the IRS (as discussed below). Some states, however, restrict the way in which articles may be composed to meet the IRS requirements for tax-exemption. Some may not allow you to include as *a part of your statement of purpose* all of the restrictions that the IRS insists upon, but will allow these restrictions to be stated in separate articles. Others may not allow the inclusion of the conventional *language* suggested by the IRS. In these cases, the IRS will accept alternative ways of stating the necessary restrictions.

Certain corporate purposes may require special approval or waivers from state agencies charged with the oversight of particular types of institutions, such as schools. A CLT with a stated educational purpose (even if it is as broad as “educating the community regarding affordable housing issues”) may be required to submit its proposed articles to the state Education Department and receive the Department's consent to their filing (or a statement by the Department to the effect that this not the type of institution whose articles it must approve).

*Role of incorporators and/or initial board.* The incorporators and the initial board may, or may not, be identical. All articles of incorporation must be signed by at least one “incorporator,” who certifies that the articles are accurate. In some cases the incorporators have the power to act for the new corporation until a regular board of directors is elected. In other cases, the articles may name those people who will serve as the initial directors (who may or may not include the incorporators). Whatever people are empowered to act for the corporation will retain this power until the first annual meeting, when a regular board will be elected. Obviously it is important to have a clear understanding of who will control the corporation initially, under the laws of your state, and to be sure that they are people who will carry out the intent of the organizers. In most cases their primary responsibility, following incorporation, will be simply to call the first annual meeting of the membership.

*Other required information.* Usually the articles must state the location of the principal office of the corporation. Sometimes they must identify the territory in which the corporation will principally operate. Check the law of your state to determine what specific information is required.

*Corporate powers granted by statute.* Obviously your CLT should have all of the powers necessary to carry out its purposes. You should determine what powers the new corporation

will have by virtue of being incorporated under the law of your state, and whether it is necessary to stipulate certain powers in the articles in order to assure that the corporation will have these powers. Even when powers are granted by statute, they may still be stipulated in the articles (sometimes done simply by quoting the statutory language), to ensure that anyone reading the articles will understand what powers the corporation has, without having to research the law itself.

*Rights and powers of members and board.* The law of your state may grant certain rights and powers to the members of the corporation and to the board of directors. Some of these rights and powers may be subject to the particular corporation's articles and bylaws. In other words, the statutory provision will apply unless the articles or bylaws provide otherwise. Other rights and powers may be granted absolutely by the law, and may not be overridden or modified by the articles or bylaws. This distinction can be particularly important with regard to the division of powers between members and board. For instance, for a membership organization such as a CLT, the law may give the members the power to adopt and amend bylaws, even if the articles or bylaws assign this power exclusively to the board of directors. Or the law may *allow* the articles or bylaws to assign this power exclusively to the board of directors or to require the approval of both the members and the board.

*Provisions regarding meetings and decision-making.* The law may deal with a number of specific points regarding membership and board meetings, notice of meetings, quorums, voting, etc. Most of these are points that you will address in your bylaws rather than in your articles, but some may have a bearing on both documents. In any case, it is important to know what the law allows and what it *requires* regarding these matters.

*Consents and approvals required prior to filing.* As noted above, certain corporate names and purposes may require special approval from certain state agencies. The law may also require that the State Attorney General and/ or a justice of a state court consent to the filing of your proposed articles, or approve the proposed articles before filing. If you are not sure of how to handle such requirements, ask your Department of State for instructions.

**IRS requirements.** Sometimes an organization applying for tax-exempt status is told by the IRS that it cannot be recognized as exempt unless it amends its articles of incorporation. You can save yourself a great deal of time and trouble if you have a full understanding of the requirements for tax-exemption before you file your articles in the first place.

*Exempt purposes.* If the corporation is to be recognized as exempt from federal taxes under Section 501(c)(3) of the Internal Revenue Code, the corporate purposes stated in the articles must qualify, in the view of the IRS, as “charitable, educational, or scientific.” The question of what statements of CLT purposes will qualify in these terms is discussed in Chapter 6. The sample statement of purposes included at the end of this chapter is designed to qualify for exemption as well as to provide a valid statement of the purposes of a CLT – but it must be adapted to the circumstances of the particular CLT.

*Required clauses.* In addition to a statement of purposes that will be recognized as exempt, the articles of an exempt organization must contain certain clauses that prohibit it from engaging in non-exempt activities:

- A clause stating that the corporation shall not, except to an insubstantial degree, engage in any activities or exercise any powers that are not in furtherance of its primary purposes.
- A clause stating (a) that no substantial part of the corporation's activities shall consist of

carrying on propaganda, or otherwise attempting to influence legislation, and (b) that the corporation shall not participate or intervene in any political campaign on behalf of any candidate for public office.

- A clause dedicating assets to exempt purposes, and stating that no part of the net income of the corporation shall inure to the benefit of any director, member, officer or private individual.
- A clause stating that, upon dissolution of the corporation, the remaining assets shall be disposed of exclusively for the corporation's charitable purposes or to another organization with 501(c)(3) tax-exempt status.

Language covering these points is included at the end of the chapter.

**Establishing the essential features of the CLT model.** Usually when an organization is incorporated, the assumption is that its articles should restrict its activities as little as possible, allowing as much power, latitude, and flexibility as is consistent with the corporate purposes and as is allowed by statute unless there is reason to include certain specific restrictions or stipulations. As noted above, the organizers of most CLTs do have reason to include the restrictions and stipulations required by the IRS to ensure that the corporation is legally limited to exempt activities. Some have also included certain stipulations and restrictions to ensure that the corporation's activities will remain consistent with the way the CLT model – and the classic CLT model in particular – is intended to function. Others have thought it was sufficient to deal with at least some of these matters only in the bylaws.

*Members and their roles in selecting directors.* It is usually assumed that articles of a classic CLT should stipulate that the organization is to be a membership corporation (that it is not to have a self-perpetuating board). Some CLT articles also stipulate that the membership may include both lessees and non-lessees. Detailed membership requirements are usually left to the Bylaws.

*Land stewardship.* The usual assumption is that land held in trust by a CLT is not to be treated as a marketable asset. Therefore, most CLTs have included in their bylaws strict restrictions on the sale of land. These restrictions can be further strengthened and emphasized by provisions in the articles as well.

*Resale restrictions.* The basic principles of “resale-restricted” ownership of improvements on leased land are also usually set forth in CLT bylaws. Though detailed provisions for establishing such restrictions may be left to the bylaws and to subsequent action by members and directors, the articles often do specify that the membership and Board are responsible for seeing that resale prices of housing or other improvements on land leased by the Corporation to low or moderate income people are to be restricted to preserve affordable access for such people.

### **Sample Language.**

**Corporate purposes.** *(Not all of the following statements of purposes are appropriate for all CLT programs. Be sure to read Chapter 6 on tax-exemption issues before drafting corporate purposes for your CLT.)*

The purposes for which the Corporation is formed are exclusively charitable. The specific and primary purposes are:

- (a) To provide housing for low-income [or low and moderate income] people that is safe, secure and affordable.
- (b) To provide affordable homeownership opportunities for low-income [or low and moderate income] people, while preserving the quality and affordability of the homes for future low [or low and moderate] income residents of the community.
- (c) To combat community deterioration in economically disadvantaged neighborhoods by promoting the development, rehabilitation, and maintenance of decent housing in these neighborhoods; by promoting economic opportunities for low-income residents of these neighborhoods; by making land available for projects and activities that improve the quality of life in these neighborhoods; and by assisting residents of these neighborhoods in improving the safety and well-being of their community.
- (d) To protect the natural environment and to promote the ecologically sound use of land and natural resources and the long-term health and safety of the community.
- (e) To lessen the burdens of government by entering into agreements to preserve the affordability of housing made affordable through government subsidies or government policies.

**Language specific to the Internal Revenue Code:**

Notwithstanding any other provisions of these articles, the corporation is organized exclusively for one or more of the purposes as specified in §501(c)(3) of the Internal Revenue Code of 1954, and shall not carry on any activities not permitted to be carried on by a corporation exempt from Federal income tax under IRC §501 (c)(3) or corresponding provisions of any subsequent Federal tax laws. No part of the net earnings of the corporation shall inure to the benefit of any member, trustee, director, officer of the corporation, or any private individual (except that reasonable compensation may be paid for services rendered to or for the corporation), and no member, trustee, officer of the corporation or any private individual shall be entitled to share in the distribution of any of the corporation assets on dissolution of the corporation.

No substantial part of the activities of the corporation shall be carrying on propaganda, or otherwise attempting to influence legislation [except as otherwise provided by IRC §501 (h)] or participating in, or intervening in (including the publication or distribution of statements), any political campaign on behalf of any candidates for public office.

In the event of dissolution, all of the remaining assets and property of the corporation shall, after necessary expenses thereof, be distributed to another organization exempt under IRC §501 (c)(3), or corresponding provisions of any subsequent Federal tax laws, or to the Federal government, or state or local government for a public purpose, subject to the approval of a Justice of the Supreme Court of the State of New York.

In any taxable year in which the corporation is a private foundation as described in IRC §509(a), the corporation shall distribute its income for said period at such time and manner as not to subject it to tax under IRC §4942, and the corporation shall not (a) engage in any act of self-dealing as defined in IRC §4941(d), retain any excess business holdings as defined in IRC §4943(c), (b) make any investments in such manner as to subject the corporation to tax

under IRC §4944, or (c) make any taxable expenditures as defined in IRC §4945(d) or corresponding provisions of any subsequent Federal tax laws.

## Chapter 4

# CLT Bylaws Considerations

This chapter deals with basic considerations involved in drafting bylaws for various types of CLT organizations. Model bylaws for “classic” CLT organizations are presented in Chapter 5-A. Detailed commentary on these model bylaw is presented in Chapter 5-B.

### **The Role of Bylaws for a CLT**

**What are bylaws?** As noted in Chapter 3, “Incorporation and Basic Structural Considerations,” bylaws establish rules for the governance of the organization. They are a binding legal document, but they are established internally, by the members and/or board of directors after the corporation has been established through the filing of articles of incorporation. Bylaws do not need to be filed with a government agency in the process of creating the corporation, but some government agencies, including the IRS, require that they be submitted in connection with subsequent processes.

Bylaws must be fully consistent with the articles of incorporation, but they are much more detailed than the articles with regard to the governance of the organization. Though bylaws are not formally adopted until after articles are filed, it is strongly recommended that they be *drafted before* the articles are filed – both to ensure consistency with the articles and because the drafting of bylaws is *the* process by which the specific shape of the CLT will be determined. The group that creates the CLT normally does not want simply to pass on to the eventual members and/or directors of the organization the responsibility for answering the many questions that this process must address. (The initial members and board are not legally obligated to adopt the previously drafted bylaws, but there is normally enough continuity between the founders and the initial members and board so that it is assumed that what has already been drafted will be adopted.)

Bylaws must also be consistent with the state’s not-for-profit corporation law. The group that drafts the bylaws (or the attorney working with that group) should be familiar with this law (usually easy to access on the internet and usually not so technical or extensive that it is hard to read). In general, not-for-profit corporation laws give a good deal of latitude to those drafting bylaws (sometimes requiring that an organization do certain things *unless* the bylaws specify otherwise). It is important to know what the law does require, but it is generally not necessary to incorporate the language of the specific state law in the bylaws (though some attorneys may recommend this practice in order to guarantee strict consistency with the law).

**The Importance of CLT bylaws.** Founders of new organizations sometimes view bylaws as a kind of formal requirement that will not really have much bearing on what the organization does in the future. In fact there is a tendency for some nonprofits to “leave their bylaws behind” as they adapt their structures and procedures to changing personnel and changing needs and problems. For nonprofits that do not have significant assets and do not enter into long-term contracts, this kind of organizational fluidity may or may not cause serious problems. A CLT, however, is not that kind of organization.

The future of a CLT may seem hypothetical at the time when its bylaws are drafted, but imagine a time when it has a hundred or more households leasing land from it, all of them with an interest in CLT decisions that may affect their security and equity as homeowners.

Neighbors of these homeowners, though not living on CLT land, are also realizing that the CLT has come to have an impact on their neighborhood(s) and that they, too, have an interest in its decisions. Some of these neighbors are homeowners; some may be tenants who are interested in becoming CLT homeowners. Others who may have an interest in the CLT's actions include public officials, merchants, representatives of other nonprofit organizations, and advocates for a variety of other local interest groups.

The membership (in the case of a classic CLT) and the board of directors will not simply be people who have come together because they share a common concern for the community. They will indeed have this common concern, but they will also represent differing interests and perspectives within that community. Clearly, an organization that includes and affects these varied interests must be guided in its decisions by rules that are respected by all participants. The bylaws will provide these rules, and it is important that they be rules that will allow the CLT to work through future decisions in a systematic and even-handed way.

## **Typical Contents**

Bylaws vary considerably in their length and the extent to which they spell out detailed rules. The model bylaws for classic CLTs presented in the next chapter are quite detailed in most respects. They include detailed provisions relating to the membership and board structures that are essential features of the classic CLT's governance. They also include provisions relating to stewardship issues that should be a concern of any CLT, regardless of how it is governed.

The outline presented below is *not* a model; it is only a sketch of basic subject areas that a group developing bylaws for any form of CLT organization should consider.

### *I. NAME AND PURPOSE*

The name of the organization should be stated exactly as it appears in the articles of incorporation. Any inconsistency (e.g., using the abbreviation "Corp." in one document and "Corporation" in the other) may cause the IRS to return a tax-exemption application.

It is not necessary to include a statement of purpose in the bylaws, but, if you choose to do so, the statement should be fully consistent with the statement of purpose in the articles of incorporation. The safest way to avoid inconsistencies that might raise questions is to repeat the statement from the articles word for word.

### *II. MEMBERSHIP*

This article can be omitted if the organization is not a "membership corporation" as defined in Chapter 3 and if your state's not-for-profit corporation law does not require that the members of the board of directors be identified as the members of the corporation.

For membership corporations such as "classic CLTs," this article is important. It may distinguish between different categories of membership (e.g., "leaseholder members" vs. "general members,"(in the case of classic CLTs) or individual members vs. institutional members. It will define who qualifies for membership; the role of the members in electing the board of directors (if they have a role); the rights of members; the obligations of members (including payment of dues, if required); when and how membership may be terminated, etc.

### III. BOARD OF DIRECTORS

This is obviously an important part of any bylaws. Normally the article will cover the following topics, in greater or lesser detail.

- *Number of Directors*: either requiring a specific number or minimum and maximum numbers.
- *Terms of Directors*: number of years (sometimes varied for initial directors in order to create “staggered” terms); limits, if any, on number of terms to be served.
- *Election*: who is eligible for election, who elects, what are the processes for nomination and election, how are vacant seats to be filled.
- *Meetings of the Board of Directors*: annual meetings, other regular meetings, special or emergency meetings, notices of meetings, quorums for meetings, decision making processes, minutes.
- *Duties of the Board of Directors*: broadly defined duties (responsibility for general management of the affairs of the Corporation, including financial management), and specific duties such as election of officers, authorization for signing of checks, deeds, leases, contracts, etc., authorization for borrowing, approval of annual budgets, etc.
- *Committees*: what specific committees are required (if any), who is eligible to serve on committees (only board members, or others as well?), who appoints members (usually the President).

### IV. OFFICERS

This article identifies the officer positions to be filled – most commonly President, Vice President, Secretary and Treasurer (sometimes by other names) – and states how and when they are to be selected (typically they are elected by the board at its annual meeting), and how long they are to serve. Usually the duties specific to each officer position are then stated, in more or less detail.

### V. CONFLICT OF INTEREST POLICY

A conflict of interest policy is important for charitable organizations – particularly for those such as CLTs that manage relatively large sums of money and control valuable real estate – since none of the assets of such organizations must be allowed to “inure to the benefit” of the individuals who control the organization. A sample conflict of interest policy appears in Article V of the Model Classic CLT Bylaws presented in chapter 5-A. A sample of a more elaborate policy is presented by the IRS in an appendix to the Form 1023 Instructions, which is accessible online. (Organizations applying for 501(c)(3) tax exempt status are not required to copy this sample, but do need to affirm that they have adopted a conflict of interest policy.)

### VI. STEWARDSHIP

Any organization identified as a community land trust – regardless of its corporate structure – will necessarily have a major concern with the stewardship of land and (in most cases) housing on behalf of the community it serves. The founders of the CLT will normally want to establish the intended principles of stewardship in the bylaws, so that those who govern the organization will be formally obligated to observe these principles. In the Model Classic CLT Bylaws presented in chapter 5-A, these principles are addressed in Articles VI and VII. Even those organizations that do not adopt the classic model in other respects should look carefully at these articles and consider how to adapt them to whatever corporate

structure they are establishing.

#### *VII: AMENDMENT OF ARTICLES OF INCORPORATION AND BYLAWS*

This article will state how amendments are to be approved. Bylaws of membership organizations such as classic CLTs may require approval by both the board and the membership. It is common for bylaws to require a supermajority vote (e.g. two thirds or three quarters) for approval of amendments, and to impose special requirements for notices of meetings in which amendments are to be considered (sometimes calling for longer notice, and often calling for inclusion of the specific amendment resolution to be voted upon).

#### *VIII: DISSOLUTION*

This article spells out the process for *authorizing* the dissolution of the corporation – typically in terms that parallel those of the amendment process described above – supermajority approval, perhaps by both membership and board, in meetings with special notice requirements. The process must comply with the state’s requirements for dissolution of a corporation (as well as the IRS requirements for dissolution of a 501(c)(3) organization); however, the bylaws do not need to spell out all of the steps that must be taken to complete the dissolution process with the appropriate state offices under applicable laws.

#### *ARTICLE IX: MISCELLANEOUS PROVISIONS*

Miscellaneous provisions that may be presented in this article include: definition of the corporation’s fiscal year, provisions for the disbursement and deposit of funds, the lending or borrowing of funds, and provision for indemnification of officers and directors if they incur expenses resulting from an action against the corporation.

### **Basic Drafting Considerations**

**Internal consistency.** Though bylaws are made up of many separate rules, it is obviously important that these rules be consistent with each other. It is not an easy matter to maintain this consistency as you draft and revise bylaws, article by article and paragraph by paragraph. Any time that you consider adding, deleting, or changing particular provisions within your draft bylaws, you will need to think about what other changes may then be required in other parts of the draft in order to avoid contradictions and confusion.

It is also important to be sure that terminology is used consistently throughout the bylaws – especially in the case of key terms to which specific meanings are assigned. For instance, in Article II of the Model Classic Bylaws, the term “general members” is defined as meaning members who are not CLT lessees. It would then be very confusing if the term were used elsewhere in the bylaws to mean members-in-general, including lessee members.

**Specificity vs. flexibility.** To what extent should bylaws spell out detailed procedures that must be followed in certain situations? To what extent should they establish only general rules that give the board of directors freedom to adopt and revise policies to deal with situations as they evolve? There is no one general answer to these questions. A degree of flexibility is important. The founders of a CLT cannot possibly anticipate all of the complicated situations that will be faced in the future, and they should be wary of prescribing detailed procedures for dealing with what they cannot foresee. At the same time, the founders should establish a procedural framework that is specific enough so that future members and board will be able to concentrate on the substance of their work and will

not have to spend a great deal of time and energy debating procedural questions. The founders also have good reason to establish some specific provisions to ensure that the essential features of the CLT are not compromised as the organization addresses future opportunities and problems.

The Model Classic CLT Bylaws presented in the next chapter deal in considerable detail with matters relating to the membership and board structures that are essential to the classic CLT model. CLT organizations that have not adopted – or have adopted only part of – these governance structures may have less need for the level of specificity found in the model bylaws. However, they may still have reasons to adopt very specific bylaws provisions relating to the CLT’s stewardship functions.

**“Realism” vs. “idealism.”** The CLT model is based on an ideal of democratic local control, and it should demand of its members and directors a certain commitment of time and energy in support of this ideal. At the same time, if a CLT is to succeed in the real world, its bylaws must provide rules and procedures that are realistic in what they require of members and directors. We may believe that all directors ought to attend all Board meetings, but we recognize that it would not be realistic to establish a 100% quorum for these meetings or to require the removal from the board of a director who misses a single meeting.

How much should requirements be modified in order to allow for busy and conflicting schedules, occasional forgetfulness, normal human frailty? How rigorous must the requirements remain in order to command the commitment of time and effort necessary to the organization’s success? People will not necessarily agree on the answers to these questions. Some of those involved in drafting bylaws may think certain specific requirements are overly rigorous, while others may think they are not rigorous enough. They will need to find a compromise that is acceptable to both sides.

The issue of realism is also related to the issue of specificity vs. flexibility discussed above. In some situations, it may seem that the best way to assure sound decisions and to protect the interests of all affected parties is to require an elaborate decision-making process with a number of specific checks and balances built into it. Yet, if the process is made too complicated, there is a danger that it will short-circuit – that people will lose patience with the elaborate requirements of their bylaws, or will simply forget them, and will improvise simpler (perhaps inadequate) procedures.

Another important consideration is the effect that your bylaws – and the procedures they establish – will have on the composition of your membership and board of directors. Bylaws that require too great a commitment of time from members or directors, or that require a commitment to an inflexible schedule of meetings, may discourage participation by busy people – and in particular by lower-income people who are juggling multiple jobs (probably with inflexible work hours), childcare, and other responsibilities.

It should be said, however, that the most “realistic” bylaws are not necessarily those that make the least demands and impose the least restrictions on members and directors. It is unrealistic to ask too much of people, but it is equally unrealistic to think that the organization can succeed without ever inconveniencing its members or directors. CLT bylaws must make certain demands on people. They must also place certain restrictions on the possibility of self-serving decisions by members and directors (such as a decision to change the resale formula in order to grant more equity to lessees).

In many respects, then, CLT bylaws must be a carefully balanced set of compromises, based on a clear vision of the real world in which the CLT will operate, as well as on a clear vision of what it is intended to achieve. The best general advice to those drafting bylaws continues to be: “Imagine the future – realistically.”

### **HOME Program Issues**

One very specific consideration in drafting bylaws involves the federal “HOME Investment Partnership Program,” which has become an important resource for CLTs and as such has sometimes affected their bylaws. The program, established by the Cranston-Gonzales National Affordable Housing Act in 1990, provides block grants to states and qualifying municipalities to support affordable housing efforts. Each of these “Participating Jurisdictions” (“PJs”) must reserve at least 15% of its HOME funds for investment in housing that is to be “developed, sponsored or owned” by nonprofit organizations that the PJ has certified as “community housing development organizations.” In addition, the PJ may use up to 5% of its grant to provide operating support to such organizations. For these reasons, it is generally very much in the interest of a CLT to be “certified” by its PJ as a “CHDO” (pronounced “chodo”), as these organizations are called.

**CHDO status for CLTs.** Adopting the language of the 1990 Act, the HOME Program Regulations (at 24 CFR 92.2) define a community housing development organization as an organization that, among other things, “maintains accountability to low income community residents by:

- (i) Maintaining at least one third of its governing board’s membership for residents of low-income neighborhoods, other low-income community residents, or elected representatives of low-income neighborhood organizations. For urban areas, community may be a neighborhood or neighborhoods, city, county, or metropolitan area.; for rural areas it may be a neighborhood or neighborhoods, town, village, county, or multi-county area (but not the entire state); and
- (ii) Providing a formal process for low-income program beneficiaries to advise the organization in its decisions regarding the design, siting, development and management of affordable housing.”

As defined in the Housing and Community Development Act of 1992<sup>1</sup>, a community land trust “is a community housing development organization that [among other things]...

Has a board of directors which includes a majority of members who are elected by the corporate membership and is composed of equal numbers of (1) lessees, (2) corporate members who are not lessees, and (3) any other category of persons described in the bylaws of the organization; and

Is not required to have a demonstrated capacity for carrying out HOME activities or a history of serving the local community within which HOME-assisted housing is to be located. [*See Appendix B for the full text of the federal definition.*]

In the past, some public officials (both inside and outside of HUD) interpreted the 1992 legislation to mean that any organization that otherwise conforms to the statutory definition of a CLT is by definition a CHDO. However, other officials assumed that if a CLT is to be considered a CHDO it must first meet the basic CHDO requirements established by the 1990 legislation (except for the explicit exclusion regarding demonstrated capacity and history of service). In 2001, the HUD Office of Affordable Housing published a notice affirming the

latter interpretation:

For the purpose of receiving CHDO set-aside funds to produce HOME-assisted housing, CLTs must undergo the same designation process as any other nonprofit organization seeking CHDO status (See CPD Notice 97-11, “Guidance on Community Housing Development Organizations (CHDOs) under the HOME Program.”). However, Section 233(f) of NAHA exempts CLTs from two of the requirements applicable to other CHDOs....<sup>2</sup>

Given this interpretation, a CLT seeking certification as a CHDO is required to show that at least one-third of its board of directors meets the “low-income test” deriving from the 1990 legislation.

A few PJs have treated the requirement as a matter of “performance,” asking the CLT to show, at the time it seeks CHDO certification, that at least one third of its board consists of people who are in fact “residents of low-income neighborhoods, other low-income community residents, or elected representatives of low-income neighborhood organizations.” A larger number of PJs, however, have treated the test as a structural matter, asking the CLT to show that its bylaws specifically *require* that at least one-third of its board be “residents of low-income neighborhoods, other low-income community members, or elected representatives of low-income neighborhood organizations.” In some cases, PJs have simply accepted an argument that can be made by some (but not all) CLTs: that their bylaws reserve a third of the seats on the board of directors for lessee representatives, all of whom are low-income when they first purchase their homes, and that another third of the board seats are reserved for general representatives, most of whom normally reside in the low-income community that is served. A number of other PJs, however, have required CLTs to amend their bylaws to add an explicit requirement for one-third low-income representation in order to gain certification as a CHDO.

For classic CLTs, these amendments have not replaced the classic tri-partite board structure; instead, they have been attached as a kind of overlay. It is generally not clear how the electoral process described in the classic bylaws is to ensure the election of a board that will meet the low-income requirement. In practice, this overlay of one set of structural requirements upon another, has not been a problem. CLTs have tended to achieve strong representation of low-income people and neighborhoods within their boards of directors (in fact stronger than many other types of CHDOs), without having to modify the process by which board members are elected. The current version of the Model Classic CLT Bylaws, in (Article III, Section 6) charges the membership and board of directors with responsibility for seeing that the requirement is met – “in their actions regarding the nomination and election of directors and appointment of people to fill vacancies on the board of directors” – but does not say exactly how they are to fulfill the responsibility.

**Conflict of interest under the HOME program.** The HOME Final Rule adds another complication of which CLTs should be aware. The Rule’s conflict of interest provision (24CFR Section 92.356) has been read by some officials inside and outside of HUD to prohibit lessee participation on the CLT’s board of directors by any lessee living in a HOME-assisted housing unit. Even though the Rule explicitly states – at 92.356(f)(1) – that the conflict of interest provision “does not apply to an individual who receives HOME funds to acquire or rehabilitate his or her principal residence,” some public officials have insisted, “just to be safe,” that a CLT limit participation on its board of directors only to lessee

representatives (and, for that matter, to general representatives) who have not been beneficiaries of HOME assistance.

Aside from arguing that the conflict of interest provision simply does not apply to CLT lessees, there is another route that CLTs may take in attempting to maneuver around local interpretations of this provision that would ban all HOME beneficiaries from the CLT board. The Rule allows HUD to grant an exemption to this provision to any PJ that requests it. One of the factors which HUD must consider in deciding whether to grant such an exemption is “whether the person affected is a member of a group or class of low-income persons intended to be the beneficiaries of the assisted activity, and the exception will permit such person to receive generally the same interests or benefits as are being made available or provided to the group or class.” Since a CLT’s lessees would typically fit this definition of a “class of low-income persons intended to be the beneficiaries” of the HOME program, there would seem to be strong grounds for an exemption allowing CLT lessees to serve on the CLT’s board of directors (especially since the Housing and Community Development Act of 1992 includes a definition of the CLT that requires one-third of the CLT’s board of directors to be “composed of” lessees).

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<sup>1</sup> The language quoted here from the Housing and Community Development Act of 1992 was incorporated in early versions of the HOME program regulations. Unfortunately, although these specific provisions for CLTs remain a part of federal law, they are included in HUD’s streamlined “Final Rule” only by reference. Buried within earlier federal regulations, these CLT provisions are harder to find, resulting in an increase in the number of federal state, and municipal officials who are not even aware that these CLT provisions exist. Relevant portions of the 1992 legislation are included in Appendix B.

<sup>2</sup> HOMEfires: Policy Newsletter of the HOME Investment Partnership Program, Office of Affordable Housing Programs, Vol. 3, No. 10, October, 2001.

## **Chapter 5-A**

# **Model Classic CLT Bylaws**

These Model Bylaws do not differ greatly from those published by the Institute for Community Economics in the 1991 Edition of the CLT Legal Manual, which had evolved from existing CLT bylaws – most of which had themselves been adaptations of earlier “model bylaws” provided by ICE. The version of the Model published in the 2002 Revised Edition of the Legal Manual was further shaped by the experience of existing CLTs as they implemented and “lived with” their bylaws. The Model Bylaws presented here reflect further experience, but the changes are still limited (where they occur they are discussed in the commentary presented in Chapter 5-B). The “classic” CLT structure embodied in the Model Bylaws has become quite well established and is not changing rapidly. However, variations on the classic model continue to proliferate as local groups adapt the classic model to local circumstances. It will continue to be important for the organizers of new CLTs to think through their own goals and the realities of their own communities as they draft their own bylaws.

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## Model Classic CLT Bylaws

### ARTICLE I: NAME AND PURPOSE

1. Name. The name of this organization shall be \_\_\_\_\_, hereinafter referred to as the “Corporation.”
2. Purpose. The purpose of the Corporation shall be:  
*[State the purpose as it appears in the articles of incorporation.]*

### ARTICLE II: MEMBERSHIP

1. **Regular Membership.** Subsequent to the first annual meeting, the Regular Members of the Corporation, with full voting rights, shall be:
  - a. The Lessee Members, who shall be all persons who lease land or housing from the Corporation or who lease or own housing that is located on land leased by another entity from the Corporation.
  - b. The General Members, who shall be all other persons, eighteen years of age or older, who have complied with the following requirements.
    - (1) Submission of a Membership application including a signed statement of support for the purposes of the Corporation in a form to be determined by the Board of Directors.
    - (2) Payment of dues as established by the Membership for the current calendar year.
2. **Requirements for Continuing Regular Membership.** To maintain Regular Membership beyond a person’s first year of Regular Membership a person must either be a Lessee Member or have paid dues established for the current calendar year.
3. **Membership Dues**
  - a. Annual membership dues shall be assessed for each calendar year by an affirmative vote of a majority of the Regular Members present and voting at the Annual Meeting preceding that year. If no such action is taken to assess dues for a given year, the dues for that year shall be as established for the previous year.
  - b. Annual dues may be paid either in cash or through a contribution of labor to the organization. The Board of Directors shall determine the hourly rate at which labor will be credited as dues, and shall have the power to designate the types of labor that may be credited.
4. **Rights of Regular Members.**
  - a. Every Regular Member shall have the right to participate in meetings of the Membership, to cast one vote on all matters properly put before the Membership for consideration, to nominate and participate in the election of the Board of Directors as provided by these Bylaws, to serve on the Board of Directors or on committees if chosen, and to receive notices and minutes of Membership Meetings and Annual Reports of the Corporation.

- b. The assent of the Regular Membership, in accordance with these Bylaws, shall be required before action may be taken on the assessment of membership dues, the sale of land, the establishment or alteration of the “resale formula,” the amendment of the Certificate of Incorporation or these Bylaws, and the dissolution of the Corporation.

#### **5. Supporting Membership.**

- a. Any person who has paid the annual dues established for the current calendar year but who does not wish to become a Regular Member or has not met all of the requirements of Regular Membership shall be designated a Supporting Member of the Corporation.
- b. Supporting Members shall have all of the rights of Regular Members *except* the right to nominate and participate in the election of the Board of Directors and the right to vote on matters put before the Regular Membership.

#### **6. Membership Meetings.**

- a. *Notice of Meetings.* Written notice of every Membership Meeting shall be given to all Regular and Supporting Members and shall include an agenda for the meeting. Except as otherwise provided in Article VIII of these Bylaws, notice shall be mailed at least seven days prior to a meeting.
- b. *Annual Meetings.* Subsequent to the First Annual Meeting, the Annual Meeting of the Membership, for reports to the Membership by the Board of Directors and Officers, the election of Directors, the assessment of dues, and the transaction of other business, shall be held in the fourth quarter of each year. The location and specific time of the Annual Meeting shall be determined by the Board of Directors. Notice of the Annual Meeting shall include a list of those persons nominated for the Board of Directors as provided in Article III of these Bylaws.
- c. *Regular Meetings.* Regular Meetings may be scheduled by the Regular Membership at such times and places as they shall establish at the Annual Meeting.
- d. *Special Meetings.* Special Membership Meetings may be called by the Board of Directors or by a written petition, addressed to the President of the Corporation, signed by at least one tenth (10%) of the Regular Membership. At a Special Meeting, only those matters stated on the agenda, as included in the notice of the meeting, may be acted upon by the Membership.
- e. *Open meetings.* All Membership Meetings shall be open to any person.
- f. *Minutes.* Minutes of all Membership Meetings shall be recorded by the Secretary of the Corporation or by another person designated by the Board of Directors. Minutes for every meeting shall be approved by the Regular Membership at the next Membership Meeting.
- g. *Quorum.* A quorum shall consist of \_\_\_ percent of the total Regular Membership, as determined by the Secretary of the Corporation.
- h. *Decision-Making.* Whenever possible, decisions shall be made at Membership Meetings by the consensus of the Regular Members present, a quorum being assembled. In the event that consensus is not attained, a decision shall be made by an affirmative vote of a majority of the Regular Members present and voting, a quorum being assembled, except as otherwise provided in these Bylaws. Before a vote is

held on any motion, the exact language of the motion shall be recorded by the Secretary and read to the Membership, and all Members present shall have a reasonable opportunity to express their opinions on the proposition.

### **ARTICLE III: BOARD OF DIRECTORS**

- 1. Number of Directors.** Except for the initial Board named in the Articles of Incorporation, the Board of Directors shall consist of twelve (12) Directors.
- 2. Composition of the Board.** There shall be three categories of Directors, each consisting of four Directors, or one third of the total Board. The three categories shall be “Lessee Representatives” representing Lessee Members, “General Representatives” representing General Members, and “Public Representatives” representing the interests of the general public.
- 3. Nomination of Directors.** For all regular elections subsequent to the first Annual Meeting of the Membership, Directors shall be nominated as follows:
  - a. Lessee Representatives.*
    - (1) Lessee Members may nominate Lessee Representatives to the Board from among themselves. These nominations must either be submitted in writing to the Secretary of the Corporation at least ten days prior to the Annual Membership Meeting or be made from the floor at the Annual Meeting.
    - (2) In the event that, at the time when the notice of the Annual Membership Meeting is to be sent out, the number of nominations is less than the number of Lessee Representative seats to be filled, the Board of Directors shall nominate enough candidates so that the total number of candidates is sufficient to fill the number of seats to be filled. To achieve this end, the Board may, at any time prior to the sending out of such notice, approve a list of candidates for Lessee Representative to be nominated in such event. In making such nominations, the Board shall select actual Lessees to the extent that they are available to serve on the Board of Directors. Otherwise the Board shall select persons who can reasonably be expected to represent the normal interests and concerns of Lessees.
  - b. General Representatives.*
    - (1) General Members may nominate General Representatives to the Board from among themselves. These nominations must either be submitted in writing to the Secretary of the Corporation at least ten days prior to the Annual Meeting or be made from the floor at the Annual Meeting.
    - (2) If, at the time the notice of the Annual Membership Meeting is to be sent out, the number of nominations for General representative is less than the number of General Representative seats to be filled, the Board of Directors shall nominate enough candidates so that the total number of candidates is sufficient to fill the number of seats to be filled. To achieve this end, the Board may, at any time prior to the sending out of such notice, approve a list of candidates for General Representatives to be nominated in such event.
  - c. Public Representatives.* At least ten days prior to the Annual Meeting, the Board of Directors shall make nominations for Public Representatives to the Board.

- d. Notice of Nominations.* A list of all persons nominated in each of the three categories shall be included with the notice of the Annual Meeting.
- 4. Election of Directors.** Directors shall be elected by the Regular Members present and voting at the Annual Meeting, a quorum being assembled, in accordance with the following procedures.
- a. A separate vote shall be taken for each of the three categories of Board representatives: (1) Lessee Representatives, (2) General Representatives, and (3) Public Representatives. If a person has been nominated in more than one category and is then elected in one category, his or her name shall be removed from the list of nominees in the remaining categories.
  - b. Only Lessee Members may vote to elect Lessee Representatives unless no Lessee members are present at the Annual Membership Meeting. If no Lessee members are present, then General Members may vote to elect Lessee Representatives. Each Member qualified to vote for Lessee Representatives may vote for as many nominees in this category as there are Lessee Representative seats to be filled.
  - c. Only General Members may vote to elect General Representatives unless no General members are present at the Annual Membership Meeting. If no General Members are present, then Lessee Members may vote to elect General Representatives. Each Member qualified to vote for General Representatives may vote for as many nominees in this category as there are General Representative seats to be filled.
  - d. All Regular Members (both Lessee and General Members) may vote to elect Public Representatives. Each Regular Member may vote for as many Public Representative nominees as there are Public Representative seats to be filled.
  - e. In each of the three categories, positions shall be filled by those candidates receiving the largest numbers of votes in the category, though such numbers may constitute less than a majority of the total votes cast in the category.
- 5. Vacancies.**
- a. If any Director vacates his or her term or is removed from the Board, the remaining Directors (though they may constitute less than a quorum) may elect a person to fill the vacancy, or may, by unanimous agreement, decide to leave the position vacant until the next Annual Meeting of the Membership, provided the Board still includes at least three Representatives in each category. Elections to fill vacancies shall be by a majority of the remaining Directors.
  - b. Any person elected to fill a vacancy on the Board of Directors must be one who can be reasonably expected to represent the interests of the constituents in the category (Lessee, General, or Public) in which the vacancy occurs.
  - c. Replacement Directors elected by the Board shall serve out the remaining term of the person who has vacated the position.
- 6. Low-Income Representation.** In their actions regarding the nomination and election of directors and appointment of people to fill vacancies on the board of directors, the membership and the board of directors shall at all times ensure that at least one third of the Board is maintained for residents of low-income neighborhoods, other low-income community residents, or representatives of low-income neighborhood organizations.

**7. Terms of Directors.**

- a. *Terms of First Elected Directors.* After the election of Directors at the first Annual Meeting, each Director shall be assigned, by mutual agreement or by lot, to a one-year or two-year term. In each of the three categories of Representatives, two Directors shall be assigned a one-year term and two shall be assigned a two-year term.
- b. *Terms of Successor Directors.* Except as otherwise provided in these Bylaws, each Director shall serve a full term of two years.
- c. *Commencement of Terms.* The term of office of a regularly elected Director shall commence at the adjournment of the Annual Membership Meeting in which he or she is elected. The term of office of a Director elected by the Board to fill a vacancy shall begin at the time of his or her acceptance of the position.
- d. *Re-election.* No person shall serve as a Director for more than three consecutive elected terms. After a year's absence from the Board, however, a person who has served three consecutive elected terms may return to the Board, if reelected, and may serve up to three consecutive elected terms.

**8. Resignation.**

- a. Any Director may resign at any time by giving written notice to the President. Unless otherwise specified, such resignation shall be effective upon the receipt of notice by the President.
- b. A Director shall be considered to have given notice of resignation and his or her position shall be declared vacant by the Board of Directors if he or she fails to attend three consecutive meetings of the Board with the exception of emergency meetings, unless good cause for absence and continuing interest in participation on the Board are recognized by the Board. When a Director has failed to attend three consecutive meetings, the President shall notify him or her in writing that, at the next regular Board meeting, his or her position will be declared vacant unless the Board determines that there has been good cause for the Director's absences and that the Director continues to be interested in participating on the Board of Directors. The notification by the President shall be mailed no later than seven days prior to the Board meeting at which the position may be declared vacant. At this meeting, the Director in question shall be given the opportunity to show good cause for past absences from meetings and continuing interest in participating on the Board. The resignation of a Director who has missed three consecutive meetings shall not become effective until the Board has declared the position vacant as provided herein.

**9. Removal of Directors.** A Director of the Corporation may be removed for good cause by the regular members of the Corporation when such Director is judged to have acted in a manner seriously detrimental to the Corporation. However, before such removal can occur, the following procedure must be followed.

- a. Written charges specifying the conduct considered to be detrimental must be signed by at least three members of the Corporation and submitted to the President (or, if the President is the Director charged, to the Vice President). Any Regular Members of the Corporation may submit such charges.

- b. The President (or Vice President) shall deliver or mail a copy of the charges to the Director charged.
- c. A Special Committee consisting of three Regular Members of the Corporation shall be created to consider the charges. One member of the Committee shall be selected by the Board of Directors, but without the participation of the Director charged, within ten days following the delivery or mailing of the charges to the Director charged. In making its selection, the Board shall endeavor to select a person who will consider the charges without bias. No later than ten days following the Board's selection of the first member of the Committee, a second member may be selected by the Director charged. In the event that the Director charged fails to select a second member of the Committee within ten days, the Board may select a second member who, in the judgement of the Board, will consider the charges without bias. Within ten days following the selection of the second member of the Committee, the first and second members shall select a third member of the Committee. If the first and second members cannot agree upon a third member within this ten-day period, the Board shall select a third member.
- d. The Special Committee shall hold a hearing, at which both the Director charged and the members who have filed charges may present evidence in the presence of the other. Following the hearing, the Committee shall prepare a written report of its findings and its recommendation for or against removal. The recommendation shall be based on a majority vote if consensus cannot be reached. The report shall contain a statement of how each member of the Committee has voted. The report shall be completed and submitted to the President of the Corporation no later than one month following the selection of the third member of the Committee.
- e. If the Committee recommends removal of the Director, the recommendation shall be presented to the Regular Membership, which shall then have sole authority to decide the question of removal. A Membership meeting for this purpose shall be called by the President for a time no later than one month following the President's receipt of the Committee's recommendation for removal. Notice of this meeting shall include a complete copy of the Committee's report.

#### **10. Meetings of the Board of Directors.**

- a. *Notice of Meetings.* Except as provided below for emergency meetings, written notice of a Board meeting shall be mailed to all Directors at least seven days prior to the meeting, or shall be delivered in person or emailed at least five days prior to the meeting. Notice of every meeting shall include an agenda for the meeting.
- b. *Waiver of Notice.* Any Director may waive any notice required by these Bylaws. Any Director who has not received notice of a Board meeting but has attended that meeting shall be considered to have waived notice of that meeting, unless he or she requests that his or her protest be recorded in the minutes of the meeting.
- c. *Annual Meeting.* The Annual Meeting of the Board of Directors may be held immediately following the Annual Membership Meeting and must be held no later than six weeks following the Annual Membership Meeting.
- d. *Regular Meetings.* The Board of Directors shall meet no less often than once every two months, at such times and places as the Board may establish.

- e. *Special Meetings and Emergency Meetings.* Special meetings may be called by the President, by any three Directors, or by 10% of the Regular Members of the Corporation. Notice must be given as provided above, unless any three Directors determine that the matter at hand constitutes an emergency. When so determined, an Emergency Meeting may be called on one-day notice. Notice of Emergency Meetings, including an announcement of the agenda, shall be given by telephone or in person to all Directors. At any Special or Emergency Meeting of the Board, only those matters included in the announced agenda may be acted upon unless all of the Directors are present at the meeting and unanimously agree to take action on other matters.

#### **11. Procedures for Meetings of the Board of Directors.**

- a. *Open Meetings.* All meetings of the Board of Directors shall be open to any person except when the Board has voted, during an open meeting, to go into executive session.
- b. *Executive Session.* A motion to go into executive session shall state the nature of the business of the executive session, and no other matter may be considered in the executive session. No binding action may be taken in executive session except actions regarding the securing of real estate purchase options or contracts in accordance with paragraph b-2 below. Attendance in executive session shall be limited to the Directors and any persons whose presence is requested by the Board of Directors. Minutes of an executive session need not be taken; however, if they are taken, they shall be recorded as a part of the minutes of the meeting in which the Board has voted to go into executive session. The Board shall not hold an executive session except to consider one or more of the following matters.
  - (1) Contracts, labor relations agreements with employees, arbitration, grievances, or litigation involving the Corporation when premature public knowledge would place the Corporation or person involved at a substantial disadvantage.
  - (2) Real estate purchase offers and the negotiating or securing of real estate purchase options or contracts.
  - (3) The appointment or evaluation of an employee, and any disciplinary or dismissal action against an employee (however, nothing in this section shall be construed to impair the right of the employee to a public hearing if action is taken to discipline or dismiss).
  - (4) The consideration of applications from persons seeking to lease land and/or housing, purchase housing or other improvements, or arrange financing from the Corporation.
  - (5) Relationships between the Corporation and any party who might be harmed by public discussion of matters relating to the relationship.
- c. *Quorum.* At any meeting of the Board, a quorum shall consist of a majority of the Board of Directors, provided that at least one representative from each of the three categories of representatives is present.
- d. *Decision-Making.* The Board shall attempt to reach unanimous agreement on all decisions. In the event that unanimous agreement cannot be achieved, a decision may

be made by a majority of the Directors present and voting, except as otherwise provided in these Bylaws.

- e. *Minutes.* Minutes of all Board meetings shall be recorded by the Secretary or by such other person as the Board may designate, and shall be corrected as necessary and approved by the Board at the next Board meeting. All duly approved minutes of Board meetings shall be kept on permanent record by the Corporation and shall be open for inspection by any Member of the Corporation.

**12. Duties of the Board of Directors.** The Board of Directors shall carry out the purposes of the Corporation, implement the decisions of the Regular Membership, and be responsible for the general management of the affairs of the Corporation in accordance with these Bylaws. Specifically, the Board shall:

- a. Approve a written Annual Report to The Membership, and make this report available to all members. This report shall include a summary of the Corporation's activities during the previous year, the Corporation's most recent financial reports, and a list of all real estate held by the Corporation.
- b. Adopt an annual operating budget prior to the beginning of each fiscal year, and approve any expenditures not included in the budget.
- c. Select all officers of the Corporation.
- d. Supervise the activities of all officers, agents, and committees of the Corporation in the performance of their assigned duties and investigate any possible conflicts of interest within the Corporation.
- e. Adopt and implement personnel policies providing for the hiring, supervision, and evaluation of employees.
- f. Provide for the deposit of funds in accordance with Article IX of these Bylaws.
- g. Determine by whom and in what manner deeds, leases, contracts, checks, drafts, endorsements, notes and other instruments shall be signed on behalf of the Corporation.
- h. Acquire such parcels of land, with or without buildings and other improvements, through donation, purchase, or otherwise, as the Board shall determine that it is useful and prudent to acquire in furtherance of the purposes of the Corporation.
- i. Convey the right to use land, through leases or other limited conveyances, in accordance with the provisions of Articles V and VI of these Bylaws.
- j. Convey ownership of housing and other improvements on the Corporation's land to qualified lessees, as possible, in accordance with the provisions of Articles V and VI of these Bylaws.
- k. Exercise, as appropriate, the Corporation's option to repurchase (or arrange for the resale of) housing and other improvements on the Corporation's land, or condominium units on which the corporation holds a purchase option.
- l. Develop the resources necessary for the operation of the Corporation and for the acquisition and development of land and housing.
- m. Assure the sound management of the Corporation's finances.

- 13. Powers of the Board of Directors.** In addition to the power to carry out the duties enumerated above, the Board of Directors shall have the power to:
- a. Appoint and discharge advisors and consultants.
  - b. Create such committees as are necessary or desirable to further the purposes of the Corporation. (Any member of the Corporation may be appointed to any committee. No committee may take action on behalf of the Corporation except as authorized by the Board of Directors.)
  - c. Call special meetings of the membership.
  - d. Approve the borrowing and lending of money as necessary to further the purposes of the Corporation and in accordance with paragraph IX-4 of these Bylaws.
  - e. Exercise all other powers necessary to conduct the affairs and further the purposes of the Corporation in accordance with the Certificate of Incorporation and these Bylaws.
- 14. Limitation on the Powers of the Board of Directors.** Action taken by the Board of Directors on any motion for the assessment of membership dues, the removal of Directors, the sale of land, the establishment or alteration of the “resale formula,” the amendment of the Certificate of Incorporation or these Bylaws, or dissolution of the Corporation shall not become effective unless and until such action is approved by the Regular Membership in accordance with these Bylaws.

#### **ARTICLE IV: OFFICERS**

- 1. Designation.** The officers of the Corporation shall be: President, Vice President, Secretary, and Treasurer.
- 2. Election.** The officers of the Corporation shall be elected by a majority vote of the Board of Directors, from among themselves, at the Annual Meeting of the Board. Any vacancies occurring in any of these offices shall be filled by the Board for the unexpired term.
- 3. Tenure.** The officers shall hold office until the next Annual Meeting of the Board after their election, unless, before such time, they resign or are removed from their offices, or unless they resign or are removed from the Board of Directors. Any officer who ceases to be a member of the Board of Directors shall thereby cease to be an officer.
- 4. Removal from Office.** The officers shall serve at the pleasure of the Board of Directors and may be removed from office at any time by an affirmative vote of two thirds of the entire Board of Directors
- 5. Duties of the President.** The President shall:
  - a. Preside at all meetings of the Board of Directors and the Membership when able to do so.
  - b. Consult with the other officers and the committees of the Corporation regarding the fulfillment of their duties.
  - c. Assure that an agenda is prepared for every meeting of the Membership and the Board of Directors.
  - d. Give notice to any Director who has been absent from three consecutive regular

meetings, as required by these Bylaws.

- e. Call special meetings of the Membership or Board of Directors when petitioned to do so in accordance with these Bylaws.
- f. Carry out the duties assigned to the President regarding the removal of a Director.
- g. Perform such other duties as the Board of Directors may assign.

**6. Duties of the Vice President.** The Vice President shall:

- a. Perform all duties of the President in the event that the President is absent or unable to perform these duties.
- b. Perform those duties assigned to the President regarding the resignation or removal of a Director when the President is disqualified from performing these duties.
- c. Assure that up-to-date copies of these Bylaws (incorporating any duly approved amendments) are maintained by the Corporation; answer all questions from the Board regarding these Bylaws; and assure that all actions of the Membership and Board of Directors comply with these Bylaws.
- d. Assure that any and all committees established by the board of directors are constituted as the board has directed and meet as necessary and appropriate.
- e. Perform such other duties as the Board of Directors may assign.

**5. Duties of the Secretary.** The Secretary shall:

- a. Assure that a list of all Members and their mailing addresses is maintained by the Corporation.
- b. Assure that proper notice of all meetings of the Membership and the Board of Directors is given.
- c. Assure that motions and votes in meetings of the Membership and Board are accurately represented to those present and are accurately recorded in the minutes.
- d. Assure that minutes of all meetings of the Membership and the Board of Directors are recorded and kept on permanent record.
- e. Perform such other duties as the Board of Directors may assign.

**8. Duties of the Treasurer.** The Treasurer shall oversee the finances of the Corporation. Specifically, the Treasurer shall:

- a. Assure that the financial records of the Corporation are maintained in accordance with sound accounting practices.
- b. Assure that funds of the Corporation are deposited in the name of the Corporation in accordance with these Bylaws.
- c. Assure that all deeds, title papers, leases, and other documents establishing the Corporation's interest in property and rights in particular matters are systematically and securely maintained.
- d. Assure that all money owed to the Corporation is duly collected and that all gifts of money or property to the Corporation are duly received.
- e. Assure the proper disbursement of such funds as the Board of Directors may order or authorize to be disbursed.
- f. Assure that accurate financial reports (including balance sheets and revenue and

expense statements) are prepared and presented to the Board at the close of each quarter of each fiscal year.

- g. Assure that such reports and returns as may be required by various government agencies are prepared and filed in a timely manner.
- h. Assure that an annual operating budget is prepared and presented to the Board for its approval prior to the beginning of each fiscal year.

#### **ARTICLE V: Conflict of Interest Policy**

- 1. Duty to Corporation.** Every Board and committee member shall make decisions and carry out his or her oversight responsibilities in the best interests of the Corporation.
- 2. Interested Person.** An Interested Person is anyone who has a financial interest, either directly or through family or business relationships, in a compensation arrangement with the Corporation or in an entity with which the Corporation is considering entering into a transaction.
- 3. Appearance of a Conflict of Interest.** The appearance of a conflict of interest occurs when a reasonable person might have the impression, after full disclosure of the facts, that a member's judgment might be significantly influenced by outside interests, even though the member is not an Interested Person.
- 4. Disclosure.** Any member of the Board of Directors or a committee with powers delegated to it by the Board of Directors who believes he or she is an Interested Person or might appear to have a conflict of interest with regard to any matter coming before the Board or such committee must disclose the existence of the interest or apparent conflict to the Board or committee.
- 5. Voluntary Recusal.** If such a member believes his or her interest in a matter constitutes either a conflict of interest or the appearance of a conflict of interest, he or she shall recuse herself or himself from any discussion related to the matter and from voting on the matter.
- 6. Recusal by Board or Committee.** If the member does not voluntarily recuse herself or himself, any Board member or committee member may request that the Board or committee determine whether such member should be recused. Such member shall not be present during the discussion and vote on the recusal and may not be counted in determining the existence of a quorum at the time of such vote. In making the decision as to recusal, the Board or committee shall keep in mind that it is the Corporation's policy to avoid the appearance of a conflict of interest. If a majority of the Board or committee votes for recusal, a quorum being present, the member shall be immediately recused. The results of the vote shall be recorded in the minutes of the meeting.
- 7. Recused Members.** A recused Board member or committee member shall not be present during the discussion of the matter in regard to which he or she has been recused and shall not participate in the vote on such matter.
- 8. Agreement to Comply.** Upon joining the Board of Directors or of a committee with powers delegated by the Board of Directors, each new member shall be given a copy of this conflict-of-interest policy and shall sign a document stating that he or she has

read and understood the policy and agrees to comply with it.

## **ARTICLE VI: STEWARDSHIP OF LAND**

- 1. Principles of Land Use.** The Board of Directors shall oversee the use of land owned by the Corporation and shall convey the right to use such land so as to facilitate access to land and affordable housing by low-income [or low and moderate income] people. In so doing, the Board shall be guided by the following principles:
  - a. The Board shall consider the needs of potential lessees and shall attempt to effect a just distribution of land use rights.
  - b. The Board shall convey land use rights on terms that will preserve affordable access to land and housing for future low-income [or low and moderate income] residents of the community.
  - c. The Board shall convey land use rights in a manner that will promote the long-term well-being of the community and the long-term health of the environment.
- 2. Encumbrance of Land.** The decision to mortgage or otherwise encumber land owned by the Corporation shall require the approval of the Board of Directors. Any such encumbrance shall be subordinated to any ground leases relating to such land.
- 3. Sale of Land.** The sale of land does not conform with the philosophy and purposes of the Corporation. Accordingly, land shall not be sold except in extraordinary circumstances, and then only in accordance with the following guidelines.
  - a. A parcel of land may be sold pursuant to a resolution adopted by an affirmative vote by at least two thirds of the entire Board of Directors at a regular or special Board meeting, provided that (i) the Corporation has owned the parcel for no more than sixty (60) days at the time the vote is taken, (ii) the parcel is not leased to any party, and (iii) the resolution states that the location or character of the parcel is determined to be such that the charitable purposes of the Corporation are best served by selling the land and applying the proceeds to the support of other activities serving those purposes.
  - b. In all other circumstances a parcel of land may be sold only with:
    - (1) An affirmative vote by at least two thirds of the entire Board of Directors at a regular or special Board meeting, provided that written notice of such meeting has described the proposed sale and the reasons for the proposal; and
    - (2) The approval of two thirds of the Regular Members present at a regular or special Membership Meeting, a quorum being assembled, provided that written notice of such meeting has described the proposed sale and the reasons for the proposal.
  - c. If any of the Corporation's land is to be sold to any person or entity other than a not-for-profit corporation or public agency sharing the purposes of the CLT, any ground lessees on that land shall have the opportunity to exercise a right of first refusal to purchase the land that they have been leasing from the CLT.

**ARTICLE VII: OWNERSHIP OF HOUSING AND OTHER IMPROVEMENTS LOCATED ON THE CORPORATION'S LAND, AND LIMITATIONS ON RESALE**

- 1. Ownership of Housing and Improvements on the Corporation's Land.** In accordance with the purposes of the Corporation, the Board of Directors shall take appropriate measures to promote and facilitate the ownership of housing and other improvements on the Corporation's land by low-income [or low and moderate income] people. These measures may include, but are not limited to, provisions for the sale of housing to such people; provisions for financing the acquisition of housing by such people, including direct loans by the Corporation; and provision for grants or other subsidies that will lower the cost of housing for such people.
- 2. Preservation of Affordability.** It is a purpose of the Corporation to preserve the affordability of housing and other improvements for low-income [or low and moderate income] people in the future. Accordingly, when land is leased for such purpose, the Board of Directors shall assure that, as a condition of the lease, housing on the land may be resold only to the Corporation or to another low-income [or low or moderate income] person and only for a price limited by a "resale formula" as described in Section 3 below. However, notwithstanding the foregoing, the Board of Directors may choose, for reasons consistent with the charitable purposes of the Corporation, to lease certain parcels of land for uses that do not require continued affordability for low-income [or low or moderate income] people, and in such cases the resale restrictions described above shall not be required as a condition of the lease.
- 3. The Resale Formula.** Whenever its purpose is to preserve affordability, the Corporation shall restrict the price that ground lessees may receive when they sell housing and other improvements located on the land that is leased to them by the Corporation. The same policy shall be applied in the case of condominium units stewarded by the Corporation, regardless of whether the land is owned by the Corporation. A policy establishing such restrictions in the form of a "resale formula" shall be adopted by the Board of Directors and the Regular Members of the Corporation, in accordance with the following principles:
  - a. To the extent possible, the formula shall allow the seller to receive a price based on the value that the seller has actually invested in the property being sold.
  - b. To the extent possible, the formula shall limit the price of the property to an amount that will be affordable for other low-income [or low and moderate income] people at the time of the transfer of ownership.
- 4. Procedures for Adoption of the Resale Formula.** The adoption of the resale formula shall require:
  - a. An affirmative vote by at least two thirds of the entire Board of Directors at any regular or special Board meeting, provided that written notice of such meeting has set forth the proposed formula with an explanation thereof; and
  - b. An affirmative vote by at least two thirds of the Regular Members present at any regular or special Membership meeting, a quorum being assembled, provided that written notice of such meeting has set forth the proposed formula with an explanation thereof.

- 5. Procedures for Altering the Resale Formula.** The consistent long-term application of a resale formula is essential to the purposes of the Corporation. Accordingly, the resale formula shall not be altered unless the Board of Directors and Regular Members of the Corporation determine that the current formula presents an obstacle to the achievement of the purposes of the Corporation. In such event, the resale formula may be altered only by a two-thirds vote of the entire Board of Directors and a two thirds vote of the Regular Members present at a Membership meeting, as described above for the adoption of the formula.

#### **ARTICLE VIII: AMENDMENT OF ARTICLES OF INCORPORATION AND BYLAWS**

The Certificate of Incorporation may be amended and these Bylaws may be amended or may be repealed and new Bylaws adopted only by:

1. An affirmative vote by two thirds of the entire Board of Directors at any regular or special Board meeting, provided that written notice of such meeting has set forth the proposed amendment or replacement, with appropriate explanations thereof; and
2. An affirmative vote by two thirds of the Regular Members present at any regular or special Membership meeting, a quorum being assembled, provided that written notice of such meeting has set forth the proposed amendment or replacement, with appropriate explanations thereof.

#### **ARTICLE IX: DISSOLUTION**

A decision to dissolve the Corporation and to distribute the Corporation's assets in a particular manner in accordance with the Articles of Incorporation shall require:

1. An affirmative vote by two thirds of the entire Board of Directors at any regular or special Board meeting, provided that written notice of such meeting has included a full description of a proposed plan of dissolution; and
2. An affirmative vote by two thirds of the Regular Members present at a regular or special Membership meeting, a quorum being assembled, provided that written notice of such meeting, including a full description of the proposed plan of dissolution, has been given to all Members of the Corporation no later than three weeks prior to the meeting.

#### **ARTICLE X: MISCELLANEOUS PROVISIONS**

- 1. Fiscal Year.** The fiscal year of the Corporation shall begin on January 1 of each year, and shall end on December 31 of each year.
- 2. Deposit of Funds.** All funds of the Corporation not otherwise employed shall be deposited in such banks, trust companies, or other reliable depositories as the Board of Directors from time to time may determine.
- 3. Checks, etc.** All checks, drafts, endorsements, notes and evidences of indebtedness of the Corporation shall be signed by such officers or agents of the Corporation and in such manner as the Board of Directors from time to time may determine. Endorsements for deposits to the credit of the Corporation shall be made in such manner as the Board of Directors from time to time may determine.

4. **Loans.** No loans or advances shall be contracted on behalf of the Corporation, and no note or other evidence of indebtedness shall be issued in its name, except as authorized by the Board of Directors. Any such authorization shall relate to specific transactions.
5. **Contracts.** Any officer or agent of the Corporation specifically authorized by the Board of Directors may, on behalf of the Corporation, enter into those contracts or execute and deliver those instruments that are specifically authorized by the Board of Directors. Without the express and specific authorization of the Board of Directors, no officer or other agent of the Corporation may enter into any contract or execute and deliver any instrument in the name of the Corporation.
6. **Indemnification.** Any person (and the heirs, executors and administrators of such person) made or threatened to be made a party to any action, suit or proceeding by reason of the fact that he or she is or was a Director or Officer of the Corporation shall be indemnified by the Corporation against any and all liability and the reasonable expenses, including attorneys' fees and disbursements, incurred by him or her (or his or her heirs, executors, or administrators) in connection with the defense or settlement of such action, suit, or proceeding, or in connection with any appearance therein, except in relation to matters as to which it shall be adjudged in such action, suit or proceeding that such Director or Officer is liable for negligence or misconduct in the performance of his or her duties.

#### **ARTICLE XI: INITIAL MEMBERSHIP AND BOARD, ADOPTION OF BYLAWS, FIRST ANNUAL MEETING**

1. **Initial Membership.** The Initial Members empowered to vote at the first annual meeting shall be those persons 18 years of age or older who have attended at least one of the organizational meetings held between \_\_\_\_\_ [date], and the time of the First Annual Meeting, as recorded in the minutes of these meetings.
2. **Initial Board of Directors.** The Initial Board of Directors shall be as stated in the Certificate of Incorporation. The Initial Board, after approving these Bylaws, shall call the first Annual Meeting of the Membership, and shall serve until the first elected Board of Directors has been seated upon the completion of the First Annual Meeting.
3. **Adoption of Bylaws.** Adoption of these Bylaws as the Bylaws of the Corporation shall require:
  - a. Approval by a majority of the Initial Board of Directors prior to the First Annual Meeting; and
  - b. Ratification by two thirds of the Initial Members present and voting at the First Annual Meeting.
4. **Nomination of Directors to Be Elected at First Annual Meeting.** In consultation with the Initial Members, the Initial Board of Directors shall nominate a slate of twelve candidates, and shall designate four of these candidates as candidates for "Lessee Representatives," four as candidates for "General Representatives," and four as candidates for "Public Representatives." Additional nominations for any of the three categories of representatives may be made by any Initial Member from the floor at the First Annual Meeting.

- 5. First Annual Meeting.** The location and specific time of the First Annual Meeting of the Membership shall be determined by the Initial Board of Directors. Notice of the First Annual meeting shall be mailed to all Initial Members at least seven days prior to the Meeting and shall include a list of those persons nominated for the Board of Directors in accordance with Paragraph 4 above. Except as otherwise provided in this Article, the election of Directors and other business of the First Annual Meeting shall be conducted in accordance with Articles II and III of these Bylaws.

## Chapter 5-B

# Model Classic CLT Bylaws Commentary

### ARTICLE I: NAME AND PURPOSE

1. **Name.** The corporate name should be stated in the bylaws exactly – to the letter – as it appears in the articles of incorporation. If the names are not the same in the two documents, the IRS may require amendment of the bylaws to conform with the articles before tax-exempt status is recognized (even if the problem is only that the abbreviation *Inc.* appears in one document but not the other).
2. **Purpose.** A statement of purpose need not appear in the bylaws, as it must in the articles of incorporation. Nonetheless, it is practical to include the corporate purposes in the bylaws so that readers will not need to refer to a separate document to find a statement of the purposes that the bylaws are concerned with carrying out.

### ARTICLE II: MEMBERSHIP

#### 1. Regular Membership.

- a. *Lessee Members:* The language of this paragraph is intended to include tenants in buildings on CLT land, and people who are resident-members of co-ops or condominium associations that lease land from the CLT, as well as those who own individual homes on land leased from the CLT. Some CLTs may prefer to use the term “Residents” rather than “Lessees” – particularly those CLTs dealing with condominium units where the land is not leased from the CLT (in which case the paragraph should be revised to eliminate ground leasing as a necessary aspect of the definition). CLTs that deal only with single-family homeownership can use the term “Homeowners.”

Note that these Bylaws provide automatic membership for all who qualify as Lessee Members. Thus Lessee Members do not need to pay dues or meet the other requirements for General Membership. This approach is consistent with the Model Ground Lease, (Section 15.1), which states that, “The Homeowner under this Lease shall automatically be a regular voting member of the CLT.” If a CLT chooses *not* to exempt lessees from the general membership requirements, it should make sure that its ground lease does not bestow automatic membership on all lessees.

- b. *General Members:* Some CLTs limit General Membership to the residents of a specified geographical area. Others have not done so because they found it difficult to agree on the absolute boundaries of their geographical community, and because they felt the question of whether people identify with the community was more important than the question of whether they live on one side or the other of a specific boundary. CLTs that do limit general membership to residents of a specific area can still allow residents of other areas to become “supporting members” (see Section 5 of this Article).

(1) Earlier versions of the Model Bylaws required prospective members to attend an “orientation meeting” as well as submit a signed statement of support; however, most CLTs have seen this as an overly specific requirement.

2. **Requirements for Continuing Regular Membership.** Basic requirements for continuing membership are important not only as a means of encouraging active member

participation but as a clear basis for “cleaning the membership rolls” annually (removing the names of those who are no longer active members), so that it will not be unduly difficult to attain a quorum at membership meetings. Earlier versions of the Model Bylaws included attendance at a certain number of membership meetings as a requirement for continuing membership. However, most CLTs require only the annual payment of dues and do not try to record and apply attendance information in this way.

3. **Membership Dues.** Some CLT bylaws assign the power to assess dues to the board of directors. It is also possible to specify in the bylaws that dues shall be a particular dollar amount. This approach is appropriate if you intend to limit dues to a nominal sum (e.g., \$1/year), in which case there may be no need to provide for the alternative of payment through the contribution of labor. In any case, it is important to assure that a requirement of a substantial cash payment does not become a barrier to membership for low-income people.

The calendar year is established here as the simplest basis for annual dues. Another practical approach, however, is to apply dues to the period of time running from one Annual Meeting to the next – so that it is clear that all those who have paid dues during this time will be eligible to vote at the Annual Meeting that concludes the period.

4. **Rights of Regular Members.**

- b. The requirement that the membership assent to the major actions listed in this subparagraph gives the members the kind of real power that distinguishes true membership organizations from organizations that are “board-controlled.” Such requirements will of course make it more time-consuming and cumbersome to accomplish the major actions in question. There are good reasons for not allowing such actions to be taken lightly, but CLTs establishing these requirements should be clear about the consequences of the process that they are committing the organization to.

5. **Supporting Membership.** This separate, non-voting membership class is not a necessary feature of the CLT, but it can be helpful in encouraging support from people who are sympathetic with the CLT’s goals but live outside of the immediate geographical area or simply do not wish to attend meetings and vote. By establishing a supporting membership, a CLT can demonstrate broader public support and increase its revenue from dues (which may facilitate financial support from other sources), while assuring that control of the organization will remain with those most directly affected by its actions and most actively involved in its operation.

6. **Membership Meetings**

- a. *Notice.* Adequate notice of meetings is essential, but notice requirements must be realistic. (They must also be consistent with state not-for-profit corporation law.) A period of notice greater than one week may be desirable, but can be difficult to implement for officers and staff. It is possible to require a greater period of notice for certain types of meetings or for certain types of decisions, but such distinctions can be difficult to remember, and may therefore be followed less consistently. These Model Bylaws require a greater period of notice for meetings in which action is to be taken regarding dissolution of the Corporation, and a shorter period for emergency board meetings. Otherwise the Model establishes the simple requirement that notice

be mailed at least one week before all membership and board meetings.

- b. *Annual Membership Meetings.* It is wise to establish a regular pattern of annual meetings by specifying the time of year when they will take place. (When a time of year is not clearly established, busy new organizations sometimes let too much time slip by between annual meetings.) The time of year that you choose for regular annual meetings may be influenced by the timing of your first annual meeting, but you should also consider the question of when it will be most practical to seat new directors (perhaps at the beginning of the fiscal year, as a new budget goes into effect), and the question of whether the annual meeting will coincide with the presentation of the annual report.
- c-f. These are conventional provisions that should be practical for most CLTs but that can be modified if there is reason to do so.
- g. *Quorum.* The quorum is an important issue, and one in which the principle of requiring extensive member participation must be balanced against a degree of realism. If the quorum is set too low, you may not be asking enough of your members. If it is set too high, it can be difficult to gather the number of people necessary for a duly constituted meeting (without which no action can be taken legally). Generally CLTs that have developed extensive regular (i.e., voting) memberships have established very low quorums (sometimes 10% or less) for membership meetings. CLTs that have limited their regular membership to a core group of directly involved and active members (perhaps enrolling others as supporting members) have generally established higher quorums. (In any case, make sure that the quorum you establish is consistent with the not-for-profit corporation law of your state.) Some CLTs may choose to require a larger quorum for decisions on certain important issues. These model bylaws require a higher percentage vote for action on certain issues but do not require a larger quorum.
- h. *Decision-making.* This paragraph is intended to provide a practical compromise between consensus decision-making (which is difficult with a diverse group that may meet only once a year) and strict adherence to Robert's Rules of Order.
- \* **Possible Provision for Removal of Members.** It is possible for CLT bylaws to provide for the suspension or termination of membership in cases where a member has acted "in a manner seriously detrimental to the Corporation." Though these model bylaws provide for the removal of *directors*, they do not provide for the removal of members. The assumption here is that no one is likely to do as much harm by virtue of being a member as may be done by a divisive effort to terminate membership.

## ARTICLE III: BOARD OF DIRECTORS

1. **Number of Directors.** To accommodate the three-part board structure that is an established feature of classic CLT governance, the usual practice is to specify a number of directors that is divisible by three. Nine-person, twelve-person, and fifteen-person boards are reasonable, depending on the size of the organization and the number of qualified candidates available. Boards with less than nine persons concentrate great responsibility in a very small group and may lack stability and continuity as directors are

replaced. Boards with more than 15 members may be cumbersome. It is not recommended that a CLT's bylaws allow the size of the board to vary (e.g., "not less than 9 nor more than 15 directors") unless careful provisions are included to assure continued balance among the three categories of directors.

2. **Composition of the Board.** Some CLTs, while preserving the three basic board categories of the "classic" CLT, have specified subsets of representatives within these categories. For example, within the "Lessee" category, a CLT may set aside one or more seats for lessees in rental housing or lessees in co-ops or lessees occupying commercial space on the CLT's land. Within the "Public" category, a CLT may set aside one or more seats for representatives from government or representatives from the financial industry or representatives from local religious or service organizations. It should be noted that the term "Public Representative," as used here, is not intended to be synonymous with the term "governmental representative." It is the public *interest* that is being represented by these members of the CLT's Board of Directors, not necessarily the "public sector." Government officials are in fact found in the "Public Representative" category on many CLT Boards, but it is rare for a CLT to reserve more than one or two of its "Public Representative" seats for representatives from the public sector.

### 3. **Nomination of Directors.**

- a-b. *Lessee and General Representatives.* These rather complicated provisions are intended to cover both new CLTs, which may have no lessee members, and established CLTs, which may have many lessee members as well as many general members. Note that, since nominations are to be made at least ten days prior to the annual meeting and written notice is to be mailed at least one week prior to all membership meetings, three days are allowed for the preparation of the list of nominees.
- \* CLTs with lessees living in co-ops, condominiums, or other homeowner associations may wish to assign a role to these entities in nominating directors – allowing each entity to nominate a designated number of candidates in the Lessee Representative category.
- c. *Public Representatives.* Some CLTs may wish to provide further guidance regarding the nomination of "public representatives." For instance: "In making such nominations, the Board shall endeavor to identify willing candidates who are associated with other nonprofit organizations or public agencies concerned with land and housing issues in the Hometown region, or who are associated with other community land trusts or with the community land trust movement, or who, for other reasons, are in position to help the Corporation to function effectively in the larger community." Alternatively, some CLTs may have reasons for requiring specific representation of certain institutions or agencies.

### 4. **Election of Directors.**

- b-c. *Voter eligibility re election of Lessee and General Representatives.* An early version of these Model Bylaws allowed all regular members – Lessee Members and General Members collectively – to vote for (but not to nominate) both Lessee Representatives and General Representatives. The present version of the Model

adopts the different approach taken by certain CLTs – providing for the election of Lessee Representatives by Lessee Members only, and General Representatives by General Members only. This approach has been adopted so that the model will reflect the “purest” form of representation, with each of the constituencies within the membership having the right to choose its own representatives. It should be noted, however, that some CLTs have felt this approach places *too much* emphasis on the differing interests of lessees and general members, particularly for a new CLT with a small membership.

- \* CLTs that have lessees in co-ops, condominiums, or other homeowners’ associations may choose to prohibit the election of more than a designated number of Lessee Representatives from a single such organization or association. Any CLT may choose to prohibit the election of more than one Lessee Representative from a single household.
  - e. *Only a plurality is required for the election of Directors.* It is possible for bylaws to require that directors be elected by a majority vote, with provisions for additional ballots when positions are not filled by candidates receiving a majority on the first ballot. The approach taken here simplifies the process, but some CLTs may prefer the more rigorous approach, requiring a majority vote.
- 5. Vacancies.** Provisions for filling vacancies on the Board of Directors are particularly important when the Board consists of only nine people.
- a. *Election to Fill Vacancies.* Note that this paragraph calls for a majority of the *remaining* directors, not for a majority of those present and voting. Thus, if eight directors remain, an affirmative vote by five of them would be necessary, regardless of how many directors were present at the meeting.
  - b. *Qualifications of Replacements.* This requirement could be made more specific: that replacements for lessee representatives be elected from among the lessee members, and that replacements for general representatives be elected from among the general members. However, for a new CLT, with a small membership and few lessees, such a requirement may limit the choice too much.
  - c. *Term of Replacements.* An early version of these Model Bylaws provided for a replacement director to serve only until the next membership meeting, at which time the position would be filled through the regular electoral process. The present version allows the replacement to serve out the full term of the director who has been replaced – which makes it easier for the CLT to maintain the staggered terms described in paragraph 7-a.
- 6. Low-Income Representation.** This section has been added to the Revised Model Bylaws in response to the federal requirements for certification as a “Community Housing Development Organization” (CHDO) – as explained in Chapter 4, “CLT Bylaws Considerations.”
- 7. Terms of Directors.**
- a. *Terms of First Elected Directors.* This procedure for staggering terms of directors assumes twelve directors, with a regular term of two years.
  - b. *Terms of Successor Directors.* A two-year term is practical when the board consists

of twelve directors divided into three categories, as provided in these bylaws. Given such a board, with terms staggered as provided in paragraph a, there will be a smooth turnover of board members, with two directors elected in each category each year. If the board is to consist of nine directors, it is practical to establish three-year terms, so that one director is elected in each category each year. Three-year terms are also recommended for fifteen-person boards, so that five seats are filled each year, though the number in each category will differ from year to year. One-year terms are not recommended, because a certain amount of time is needed for new directors to become familiar with the working of the organization, and because it is important to have continuity within the board from year to year.

- d. *Re-election.* The number of terms allowed may depend in part on the length of term. Though this limitation on length of service may sometimes force an established leader to leave the board before some would wish, it is generally wise to set such limits to ensure that “new blood” is brought into the board at regular intervals.

## **8. Resignation.**

- b. *De facto resignation.* This paragraph is intended to provide a relatively “automatic” mechanism for replacing directors who have repeatedly failed to attend meetings. You may wish to set a different number of consecutive meetings that may be missed before this provision takes effect, depending on the frequency of regular board meetings. Or you may stipulate that such a provision will take effect if a director misses more than a certain percentage of the regular meetings in a certain period of time (e.g. 50% in one year). In any case, regular participation by all directors is important, and there should be a relatively simple procedure for replacing those who do not participate regularly.

Note that the President is assigned the responsibility of notifying the absent director. Responsibility for giving notice is more conventionally assigned to the Secretary, but, since the make-up of the Board itself is at stake, it seems appropriate to assign this specific responsibility to the President.

9. **Removal of Directors.** The removal of a director on the grounds described in this section should be clearly distinguished from the “automatic resignation” described in the previous section. To remove a director because he or she is “judged to have acted in a manner seriously detrimental to the Corporation” is obviously a very serious matter, to be undertaken only in extreme circumstances. The bylaws of many organizations provide only generally for the removal of directors for good cause, without specifying the detailed procedures included here. However, because the removal of a director is potentially a seriously divisive process for the organization, it is wise to create a carefully structured process to assure consideration of all points of view and to discourage precipitous decisions. In case such a situation ever does arise, the bylaws should provide clear guidance.

## **10. Meetings of the Board of Directors.**

- a. *Notice of meetings.* Check your state not-for-profit corporation law regarding notice requirements.
- b. *Waiver of notice.* This provision is not intended to allow board meetings to be called on short notice. Provision is made for emergency meetings for that purpose in

paragraph e. The intent here is only to provide for situations in which there is an inadvertent failure to give proper notice to all directors.

- c. *Annual meeting.* In allowing six weeks to pass between the Annual Membership Meeting and the Annual Board Meeting, the intent is to avoid scheduling problems. An even longer period might be allowed, but each new board should elect officers as soon as possible after the annual membership meeting at which new directors are elected.
- d. *Regular meetings.* Some boards meet less frequently than is here required, though they often have executive committees that meet more frequently. Our assumption is that a CLT should have a working board and that a working board for an active CLT will need to meet quite frequently. In practice, it is common for CLT boards to meet monthly, and some require monthly meetings in their bylaws.
- e. *Special and emergency meetings.* Provision for emergency board meetings can be especially important for a CLT – for instance when there is a need to act quickly to take advantage of a short-lived opportunity to acquire real estate.

#### **11. Procedures for Meetings of the Board of Directors.**

- b. *Executive sessions.* Though open meetings should be the norm, a CLT board will occasionally need to discuss matters that should not be discussed in public, either because individuals would be harmed by such discussion or because the CLT itself would be harmed. Any board must exercise reasonable judgment in deciding when to go into executive session for the purpose of discussing such matters, but the bylaws can provide useful guidance and can help to ensure that the openness of board meetings is not compromised by inappropriate executive sessions. Note that, with one exception, executive sessions are to be held only for the purpose of discussion; any binding action regarding the subject discussed should be taken in open session following the executive session. The one exception involves decisions regarding real estate purchase options or contracts. The reason for *allowing* executive session decisions in this case is that public knowledge of an impending purchase may interfere with the successful completion of the purchase on favorable terms, or may interfere with the successful completion of other purchases.

(1-5) Note that the board is not required to go into executive session to discuss any of the matters listed; it is permitted to do so, and permission is limited to *only* those matters listed.

- c. There may be reasons for establishing a quorum of more than a simple majority for the transaction of certain kinds of business. However, as in the case of notice requirements, quorum requirements that involve too many distinctions will be difficult to remember and may be less consistently observed.
- e. As written, this paragraph is intended both to allow for the appointment of a “temporary secretary” to record minutes in the absence of the Secretary and to allow for the designation of a person other than the Secretary (e.g., a staff person) to be the regular recorder of minutes at all meetings. In the latter case, the Secretary retains the responsibility for assuring that minutes are properly recorded.

## 12. Duties of the Board.

- a. *Annual report.* The requirements for the Annual Report are intended to ensure both that the Board will review the CLT's activities each year and develop a basic plan for the coming year, and that these matters will be communicated to the membership.
- b. *Operating budget.* The process of developing an annual operating budget is essential to effective planning and financial oversight. Regular adoption of an annual operating budget should be considered a duty and priority of the Board. (Capital budgets for the acquisition and development of real estate are normally treated separately, with commitments made project by project rather than fiscal year by fiscal year.)
- e. *Personnel policy.* It is assumed here that the CLT's personnel policy will spell out the role of the Board in relation to an executive director and other staff positions. However, some CLT bylaws deal specifically with the board's responsibility for hiring, overseeing and firing an executive director.
- f. *Deposit of funds.* Article IX requires that all funds not otherwise employed be deposited in "reliable depositories" to be determined by the Board. It is a basic duty of the Board to decide what account(s) will be opened for this purpose, with what institution(s). In fact, banks normally require Board resolutions authorizing the opening of an account.
- g. *Signing of deeds, etc.* It is possible for the bylaws to assign to specific officers the duty of signing certain kinds of instruments on behalf of the Corporation (when the Board has authorized the transaction in question). However it is generally more practical to allow the Board of Directors to decide who may sign what, as it develops specific procedures for operating the organization and approves specific transactions. See Article IX regarding the signing of checks and the authorization of loans and contracts.
- h-k. *Stewardship responsibilities.* These more general duties are essentially related to the Board's basic responsibility of carrying out the stewardship purposes of the Corporation. They are listed in this section as duties (rather than in the next section as powers) to emphasize the Board's responsibility for actively pursuing the CLT's purposes, and to emphasize that these activities must be carried out in accordance with the essential features of the CLT model defined in Articles V and VI.

## 13. Powers of the Board of Directors.

- a. *Retaining Advisers.* This provision allows maximum latitude to the Board in deciding who should be appointed or retained, when, for how long, and for what purposes. Bylaws may be more specific regarding the appointment of legal counsel and auditor – both of which are very important for CLTs.
- b. *Committees.* Bylaws may provide for the creation of specific standing committees, but no assumptions have been made here about what committees should be established by a particular CLT. New CLTs have a very wide range of concerns: the development of a strong membership, outreach to other organizations, research regarding ownership patterns and acquisition opportunities, legal research, development of leasing policies and a resale formula, development of resident

selection policies, fundraising, and more. Some basic tasks and oversight responsibilities relating to these concerns should normally be assigned to committees, but the number of committees and the grouping of assigned responsibilities must depend on the number of people available for active committee service.

- d. *Borrowing and lending.* The Board's power to borrow is normally essential to the acquisition and development of property. The power to lend is important for certain CLT programs, such as the operation of a loan fund for lessee's home repairs. See Article IX regarding the Board's responsibilities in contracting loans.

**14. Limitations on the Powers of the Board of Directors.** The limitations listed here are described elsewhere in the bylaws, as follows: dues (II-3); removal of Directors (III-8); sale of land (V-3); resale formula (VI-3-5); amendment (VII); and dissolution (VIII).

#### ARTICLE IV: OFFICERS

1. **Designation.** The President is sometimes identified as the "Chair" or the "Chairperson." The Secretary is sometimes identified as the "Clerk."
4. **Removal from Office.** Unlike the process for removing a Director from the Board, the process for removing an officer from his or her specific office should be relatively simple. An effective Board must have officers who carry out their duties consistently. A Board may have good reason to replace a President, for instance, who does not attend meetings regularly and is frequently unavailable to carry out other duties. Without removing such people from their Board seats, it should be possible to replace them as officers.
5. **Duties of the President.** Most of the duties listed in this section are either conventional duties of the President or are specifically assigned elsewhere in the Bylaws.
  - c. *Meeting agendas.* These Bylaws require that an agenda be included in the notice of all meetings (II-6-a and III-9-a). It is the Secretary's duty to see that proper notice is given of all meetings, but it is appropriate to require the President to see that an agenda is made available for inclusion in the notice, and therefore to hold the President responsible, with the Secretary, for seeing that the agenda is properly distributed as a part of the notice.
6. **Duties of the Vice President.**
  - b. *Duties re. disqualified President.* This paragraph refers to a situation (possible action to remove the President from the Board of Directors) that most CLTs will never face. Since the possible duties of the Vice President in this unlikely situation are specified elsewhere in the Bylaws, this paragraph might be omitted.
  - c-d. *Duties re. bylaws and committees.* The Vice President, whose responsibilities are otherwise quite limited, is given some of the special responsibilities of "parliamentarian" and "whip." The tasks involved – assuring compliance with the bylaws and proper functioning of the committees – are important and can be neglected when no one officer is charged with carrying them out.
7. **Duties of the Secretary.** Some bylaws (if read literally, as bylaws generally should be) assign to the Secretary immediate responsibility for carrying out duties relating to

membership records, notice of meetings, and minutes of meetings (e.g., “The Secretary shall give notice...”). Here responsibility is assigned for *oversight* of these matters, so that it will be clear that the actual tasks involved may be performed by staff or volunteers, when the Secretary and/or the Board choose to make such arrangements. Regarding the recording of minutes, the Board is specifically authorized (in III-11-e) to designate a person other than the Secretary to record minutes under the supervision of the Secretary.

- 8. Duties of the Treasurer.** For an organization that will accumulate substantial assets and engage in transactions involving substantial sums of money, the office of Treasurer is particularly important – and will require the commitment of a certain amount of time by this officer. The essential responsibility of the Treasurer is one of oversight. Treasurers of some smaller organizations may perform specific tasks such as reconciling checking accounts and preparing financial reports. In larger organizations, such tasks will normally be performed by staff and/or by an accountant, but the Treasurer retains responsibility for seeing that they are properly performed.
- a. *Accounting.* It is desirable – but not always necessary – that a Treasurer bring to the office a basic knowledge of accounting practices. What is most important is that the Treasurer be able and willing to work with staff and/or accountant to develop an understanding of the organization’s financial records.
  - b. *Banking.* The Board is responsible for determining what depository accounts should be opened. The Treasurer is responsible for seeing that funds are deposited in these accounts when and as appropriate.
  - c. *Documents.* It is essential that a CLT have an effective system for preserving these documents against fire, theft, and carelessness. One of the duties of the Treasurer is to see that such a system is implemented.
  - d. *Collection.* As stated, this is another basic oversight responsibility, not a requirement that the Treasurer be the immediate collector or recipient.
  - e. *Disbursement.* Bylaws may specify that the Treasurer shall sign all checks written on the Corporation’s accounts. If the question of who is to be authorized as a signatory is left to the Board, as in these bylaws, the Treasurer is still responsible for seeing that disbursements are made only as the Board has directed.
  - f. *Financial reports.* These reports may be prepared by staff or an accountant, but it is critically important that the Treasurer understand them and be able to explain them to the Board.
  - g. *Government reports.* These may be prepared by staff and/or accountant, but the Treasurer is assigned the responsibility for seeing that they are prepared and submitted when and as required.
  - h. *Budgets.* Budgets will normally be prepared by staff and/or a committee, but the Treasurer is again assigned the responsibility for seeing that the job is properly done at the proper time.

## ARTICLE V: CONFLICT OF INTEREST POLICY

Conflict of interest is obviously an important issue for an organization that will affect the

financial interests of many people. All CLTs should adopt conflict of interest policies, either as part of their bylaws or as separately adopted policies. (In the latter case, CLTs may want to include in Article III of their bylaws the requirement that the board adopt such a policy).

Previous versions of these Model Bylaws contained a basic, brief policy statement regarding conflict of interest for board members at the end of Article III. In the current version, in order to provide more specific guidance regarding procedures for dealing with potential and actual conflicts of interest, the policy statement has been expanded in the form of this separate Article V.

A different sample policy is offered by the IRS in Appendix A of the Instructions for Form 1023. (Form 1023 is required for applications for recognition of tax-exempt status under section 501(c)(3), and is available, together with the Instructions, online.) The IRS sample is a good deal more detailed than the one offered here. It is also more focused on *financial* interests and does not address questions of non-financial interests or apparent conflicts as this Article V does. Applicants for recognition of 501(c)(3) exempt status are not required to adopt a policy based closely on the IRS sample. We recommend the shorter and more broadly applicable policy presented here, but we also recommend that new organizations review the IRS sample before they adopt a policy.

Generally people should not be discouraged from serving on a CLT Board for fear of a conflict of interest on some matter that may come before the Board. The question is not whether they should serve on the Board, but whether they should participate in making decisions on matters in which they may have, or may appear to have, a conflict of interest. In fact, it should be assumed that lessee representatives and many general representatives *will* have conflicts, or the appearance of conflicts, with regard to certain Board decisions. The conflict of interest policy presented here is intended to deal with the situations in which such decisions are to be made. (Also see Chapter 4, “CLT Bylaws Considerations,” regarding conflict of interest in connection with the federal Home program.)

## ARTICLE VI: STEWARDSHIP OF LAND

1. **Principles of Land Use.** Though the principles stated are necessarily very broad, the intent of this section is to establish within the bylaws the basic principles of land use that are essential to the CLT model.
2. **Encumbrance of Land.** It is important that no mortgage or other encumbrance be allowed to take precedence over a CLT ground lease. Lessees must have assurance that, even if such a mortgage is foreclosed, their rights under the ground lease will not be affected. Earlier versions of these model bylaws required that lessees approve any mortgage on the land. This version assumes that lessees’ rights are better protected by the requirement that such mortgages be subordinated to the lease.
3. **Sale of Land.** This section establishes the basic principle that the CLT shall hold land permanently in trust and shall not treat it as something that can be bought and sold freely.
  - a. *Sale based on corporate purposes.* This paragraph did not appear in early versions of the Model Bylaws. It was added to simplify the process of selling land in situations where there is broad agreement that it does not make sense for the CLT to retain ownership – for instance, a situation in which a CLT has received a gift or

bequest of real estate that is outside the organization's service area and cannot be used by members of the community served. Some CLTs may choose to omit or modify the "within-sixty-days" requirement.

- b. *Sale in other circumstances.* Except in the circumstances described in paragraph *a* above, an affirmative vote by two thirds of the (entire) Board of Directors and two thirds of the members present at a membership meeting should probably be seen as the minimum requirement for a decision to sell land. Some CLTs may choose to require an affirmative vote by three quarters, or even a larger fraction, of the Board and/or membership.
- c. *Lessee's right of first refusal.* Such a right of first refusal is granted to ground lessees in Section 3.3 of the Model CLT Lease.

## **ARTICLE VII: OWNERSHIP OF HOUSING AND OTHER IMPROVEMENTS LOCATED ON THE CORPORATION'S LAND, AND LIMITATIONS ON RESALE**

Like the previous article, Article VI establishes essential features of the CLT model in the bylaws.

- 1. Ownership of Housing and Improvements on the Corporation's Land.** This section makes explicit the Board's responsibility not only to promote the use of the CLT's land by low-income (or low and moderate income) people but to promote opportunities for *ownership of buildings* on this land by those who use it. The intent is not to prohibit the CLT from renting homes to residents when resident-ownership is impossible or undesirable. Nonetheless, CLTs that anticipate a substantial involvement with resident-controlled rental housing will probably want to modify this paragraph.
- 2. Preservation of Affordability** This section establishes the important principle that in most cases the Board is to lease land on terms that insure that homes on the land can only be sold back to the CLT or to other "income-qualified" people, and for prices that do not exceed what is affordable for such people. However, the section allows for situations where a CLT's standard resale restrictions may be less appropriate – as for instance in the case of "mixed-income" developments where some homes are sold, without subsidies, for market-rate prices.
- 3. The Resale Formula.** Since reaching agreement on a formula requires balancing a number of concerns, the two principles presented here are qualified with the phrase "to the extent possible." See Chapter 12, "Resale Formula Design," for a full discussion of the process of designing a resale formula.
- 4. Procedures for Adoption of the Resale Formula.** Some CLTs have allowed the board alone to adopt the formula in the first place, while requiring membership approval for any subsequent *changes* in the formula. The assumption in such cases is that it would be impractical to involve the full membership in the complicated process of developing a fair and workable formula, but that, once a formula has been established and implemented, any decision to change it could have such serious consequences that the approval of the membership should be required. However, these model bylaws require membership approval of the original formula as well as of any changes in the formula – on the assumption that it is not impractical to ask the membership to approve a formula proposed by the board, and that the involvement of the membership on this issue will

strengthen their understanding of, and commitment to, the formula that is adopted.

- 5. Procedures for Altering the Resale Formula.** The basic concern here is that the formula not be changed simply for the purpose of benefiting certain individuals, even if those individuals are a preponderance of the membership. Some CLTs have required that, before a motion to change the formula can be entertained by the board, the board must determine, in a separate vote, that the current formula presents an obstacle to the achievement of the corporate purposes. Some CLTs may choose to require an affirmative vote by three quarters, rather than two thirds, of the board and/or membership for an action to change the formula.

#### **ARTICLE VIII: AMENDMENT OF CERTIFICATE OF INCORPORATION AND BYLAWS**

A two-thirds vote by directors and members, as required here, should be seen as the minimum appropriate requirement for the amendment of articles or bylaws. Some CLTs require an affirmative vote by three quarters of the directors and/or members. Others require a higher percentage vote for the amendment or repeal of those sections that establish the basic features of the CLT model (those relating to land stewardship, the resale formula, dissolution, and the amendment process itself). In general, bylaws should not make it unduly difficult to enact amendments that facilitate organizational efficiency and effectiveness but should not make it overly easy to alter those aspects of the organization that are essential to the CLT model.

#### **ARTICLE IX: DISSOLUTION**

To qualify for 501(c)(3) tax-exempt status, a CLT must include in its articles of incorporation strict limitations on the distribution of assets upon dissolution (see Chapter 6, “Tax Exemption”). It is not necessary to repeat these limitations in the bylaws. It should be noted, however, that these limitations apply to the final distribution of the *net* assets of the organization. They do not limit the organization’s right to liquidate particular parcels of real estate or other assets by selling them to any party for a fair market price.

Some CLTs do include in their bylaws more specific provisions regarding the distribution of land holdings upon dissolution. These provisions may specify that land shall be distributed to another community land trust, or, in the absence of another community land trust able and willing to assume ownership, to another organization with corporate purposes that include the long-term preservation of affordable access to land and housing for low-income people. (Regarding transfer of the CLT’s interest in land that has been leased to homeowners, see the homeowner’s right of first refusal established in Section 3.3 of the Model CLT Lease.)

Note that the period of notice required for action regarding dissolution is here stated as three weeks – the one exception to the basic requirement of one-week notice for board and membership meetings.

#### **ARTICLE X: MISCELLANEOUS PROVISIONS**

- 1. Fiscal Year.** Some organizations may have reasons for establishing a fiscal year that does not correspond to the calendar year. Often it is easier (and sometimes less

- expensive) to arrange for an audit at a time of year when accountants are typically less busy than in the months following the end of the calendar year. It may also be convenient to establish a fiscal year that corresponds with the fiscal year of a funding source from which the CLT expects (or hopes) to receive funding on an ongoing basis.
2. **Deposit of Funds.** The duties of the board and the Treasurer with regard to this basic requirement are treated in Articles III and IV.
  3. **Checks, etc.** The board's responsibility for designating and authorizing signatories is treated in Article III.
  4. **Loans.** The board's power to authorize borrowing and lending on behalf of the corporation is established in Article III. The present section makes it clear that *only* the board has the power to authorize such action, and that *each* such action must be specifically authorized. However, if the CLT establishes a loan fund to make small loans to its residents (e.g., for home repairs), it may be appropriate to amend this section of the bylaws to allow staff to approve such loans.
  5. **Contracts.** The purpose of this section, which relates to contracts other than loan contracts, is parallel to the purpose of the previous section.
  6. **Indemnification.** This section deals with the indemnification (reimbursement) of directors or officers for any costs they must pay as a result of legal actions taken against them *as* directors or officers – except in cases where they are actually found personally liable for negligence or misconduct. (Persons found *not* liable may still have substantial legal fees.) Indemnification may be required and limited by state law. Some organizations' bylaws quote the statutory provisions regarding indemnification but if these provisions are lengthy and complicated, you may prefer to say only that officers and directors shall be indemnified in accordance with state law.

#### **ARTICLE XI: INITIAL MEMBERSHIP AND BOARD, ADOPTION OF BYLAWS, FIRST ANNUAL MEETING**

Once the first annual meeting has been concluded, this article will have no continuing application to the affairs of the CLT, except as the basis for determining that due process was followed in adopting bylaws and holding the first election of directors. The provisions contained in this article could be placed in Articles II and III, but are here grouped in this separate article at the end of the bylaws so that they will not remain as potentially confusing "dead wood" among the live provisions of the earlier articles.

- 1-2. **Initial Membership and Board of Directors.** When provisions for initial members and initial directors are included in a CLT's articles of incorporation, it is not essential that they be included in the bylaws as well.
3. **Adoption of Bylaws.** It is assumed that, through the founding group's pre-incorporation meetings," the initial members and initial directors have already achieved basic agreement on the proposed bylaws. Approval by the initial board and ratification by the initial members should therefore proceed smoothly.

## Chapter 6

# Tax-Exemption

### Overview

**Types of Federal Tax-Exempt Status.** The Internal Revenue Code defines a number of types of tax-exempt status for which nonprofit corporations may qualify. CLTs that address the needs of low-income people and low-income communities normally qualify for the type of exemption defined under Section 501(c)(3) of the Code. This is the most advantageous status for a CLT because it means not only that the CLT will not have to pay federal income tax but that those making donations to the CLT will qualify for tax deductions (under current tax law). 501(c)(3) status therefore increases the likelihood of donations. It is also usually required if the organization is to receive direct grants from foundations or other charitable funding sources, and it may be a prerequisite for certain forms of state or local tax-exemption in your state.

Another type of tax-exempt status is defined under Section 501(c)(4) of the Code. A number of organizations that do not qualify for 501(c)(3) status are able to qualify for 501(c)(4) status. This status provides exemption from federal income tax, but it does not provide tax deductions for donors and does not meet the requirements of many funding sources. Most CLTs are recognized as 501(c)(3) organizations, and this chapter is primarily concerned with 501(c)(3) status.

**Achieving Recognition of 501(c)(3) Status.** In the final section of this chapter we will review the formal application process, but it is important to understand that the process involves more than filling out a form “correctly.” In making a determination of your organization’s status, the IRS will look at an extensive body of material, including articles of incorporation, bylaws, descriptions of present and projected activities, and past and projected revenue and expense. In many cases, the IRS responds to an initial application with a request for further detailed information regarding activities and policies. The process can be time-consuming, but it is not an unreasonable process given the nature of the distinctions that the IRS must make under the law. CLT organizers who have a basic understanding of these distinctions will find it easier to deal with the process of achieving 501(c)(3) status.

**Basic criteria.** An organization may qualify for exempt status under Section 501(c)(3):

- if it is “organized and operated exclusively” for specifically permitted purposes, including “charitable, religious, educational, or scientific purposes;”
- if no part of its net earnings “inures to the benefit of any private individual” and if, upon its dissolution, no part of its net assets can be passed on to anyone other than a government agency or 501(c)(3) organization;
- if “no substantial part” of its activities consists of “carrying on propaganda or otherwise attempting to influence legislation;” and
- if it “does not participate in, or intervene in, any political campaign on behalf of any candidate for public office.”

**The Organizational and Operational Tests.** The requirement that a 501(c)(3) organization be both “organized and operated” for certain purposes gives rise to what are commonly called the “organizational” and “operational” tests, both of which must be met by an applicant organization.

*Organizational test.* The organizational test is applied to a corporation's organizing documents, with the primary concern being the articles of incorporation. The primary requirement of the test is the inclusion of certain language in the articles of incorporation, limiting the purposes of the corporation to those defined as exempt under Section 501(c)(3), and explicitly prohibiting activities prohibited under Section 501(c)(3). The sample articles of incorporation presented elsewhere in this guide include the language normally required to pass the organizational test.

The IRS will also look closely at any corporate purposes enumerated in the articles of incorporation to determine whether all of them do in fact qualify as exempt. Even though your articles state that the corporation is organized exclusively for 501(c)(3) purposes, the IRS may claim that one of your specified purposes is not recognized as exempt under 501(c)(3). In such cases, the IRS may suggest that the articles be amended to delete or adjust the offending statement. Complying with such suggestions will not necessarily limit the activities of the organization if the intended activities can be justified under another purpose that is recognized as exempt. For instance, if a CLT's articles state that one purpose of the organization is to remove land from the speculative market, the IRS may object that removing land from the speculative market is not an exempt purpose in and of itself. But this does not mean that the activity of removing land from the speculative market is impermissible if, as an element of the CLT's program, it serves another purpose that is recognized as exempt – as, for most CLTs, it does.

*Operational test.* The operational test concerns the question of whether an organization is actually operated for the exempt purposes stated in its organizing documents. In applying the operational test, the IRS reviews the organization's activities and determines whether they serve exempt purposes and whether any activities violate the special restrictions and prohibitions imposed by Section 501(c)(3). The more difficult issues involved in achieving 501(c)(3) status will come up in connection with the operational test, though the question of what is and is not an exempt purpose remains central to these issues.

It should be noted that the IRS sometimes refers to "exempt activities" as though certain activities are exempt in and of themselves. This usage clearly reflects the assumption that in some circumstances certain activities necessarily serve exempt purposes and cannot reasonably be understood to serve any other purposes. Providing affordable housing directly to poor people will normally be viewed as an "exempt activity" in this sense. However, providing assistance to a business that will offer jobs to poor people will normally not be viewed as an exempt activity in and of itself, though in some circumstances it may be recognized as a means of achieving a charitable purpose.

As noted above, 501(c)(3) organizations must be organized and operated *exclusively* for exempt purposes. In other words, although the organization must necessarily engage in some activities, such as administrative activities, that are not exempt in themselves, all *programmatic* activities should qualify as exempt. Different programmatic activities need not all qualify on the same basis, but each must serve one or another exempt purpose.

**Revenue Rulings, Revenue Procedures.** In determining whether an applicant organization's activities are exempt (serve exempt purposes), IRS personnel are guided not only by the Tax Code, Tax Regulations, and court cases, but by a body of "Revenue Rulings" issued by the IRS in response to requests for advice regarding the exempt or non-exempt nature of particular organizations. Revenue Rulings are published twice each year in the Internal Revenue Service Cumulative Bulletin. The IRS also develops and publishes "Revenue Procedures," which are statements of policy on issues of concern for IRS personnel and others.

## What Is “Charitable”?

Some CLTs may have specific programs designed to serve educational purposes, and a few may have programs with scientific purposes (e.g. ecological or agricultural research), but it is unlikely that any CLT will qualify for 501(c)(3) status solely as an educational or scientific organization. Most CLTs will qualify as charitable organizations. The definition of the term “charitable” is therefore crucial.

**Basic definition.** Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations defines charitable purposes as including:

“relief of the poor and distressed or of the underprivileged; ...advancement of education; ...lessening of the burdens of Government; and promotion of social welfare by organizations designed to accomplish any of the above purposes or... to lessen neighborhood tensions; ...to eliminate prejudice and discrimination; ...to defend human and civil rights secured by law; ...or to combat community deterioration and juvenile delinquency.”

Significantly, this definition includes both purposes addressing the problems of individuals who are “poor,” “distressed,” or “underprivileged,” and purposes addressing community problems involving “neighborhood tensions,” “prejudice and discrimination,” and potential “community deterioration and juvenile delinquency.” As a practical matter, most CLT activities – and housing-related activities in particular – will qualify as charitable on the basis that they relieve the poor and distressed and/or on the basis that they “combat community deterioration,” or, in some cases, “lessen the burdens of government.”

One of the most frequently cited bases for determinations of the charitable or non-charitable nature of housing-related programs is a Revenue Ruling dating from 1970 (Rev. Rul. 70-585). An introductory paragraph of this ruling states:

“It is held generally that where an organization is formed for charitable purposes and accomplishes its charitable purposes through a program of providing housing for low and, in certain circumstances, moderate income families, it is entitled to exemption under Section 501(c)(3) of the Code. The fact that an organization receives public funds under State or Federal programs for housing is not determinative; qualification is based on whether or not the organization is charitable within the meaning of Section 501(c)(3).”

The ruling then describes four differing situations as “illustrative of the foregoing principle.” We will refer to these situations in the paragraphs that follow.

**Low income households.** In “Situation 1,” Rev. Rul. 70-585 describes an organization with “a program for new home construction and the renovation of existing homes for sale to low income families on long-term, low-payment plans....throughout the city in which it is located.” The conclusion is as follows:

“By providing homes for low income families who otherwise could not afford them, the organization is relieving the poor and distressed. Thus it is held that this organization is organized and operated exclusively for charitable purposes, and it is exempt from Federal income tax under section 501(c)(3) of the Code. The determination of what constitutes low income is a factual question based on all of the surrounding circumstances.”

In this and other rulings, the term “low income” is treated as synonymous with the term “poor,” or “poor and distressed.” Prior to 1993, the IRS offered no specific quantitative definition of “low income” – either in the Tax Code, the Tax Regulations, the Revenue

Rulings, or other publications. Providing housing or other benefits to low-income people was accepted as charitable if your definition of “low-income” was considered reasonable in relation to the “surrounding circumstances.” In applying for recognition of 501(c)(3) status, housing organizations usually defined “low income households” as the term was defined by government housing programs in which they participated – most often as households with incomes below 80% of area median income. The IRS tended to accept these definitions as reasonable, while continuing to make it clear (1) that no one definition was automatically acceptable in all circumstances, and (2) that participation in a government housing program was not in and of itself grounds for recognition as charitable.

Beginning in 1993, however, the IRS modified its approach to the matter of definition. In the course of establishing so-called “safe harbor” guidelines for charitable housing organizations, the IRS adopted the specific quantitative definitions of “low income” and “very low income” used in federal housing programs. The safe harbor guidelines define a set of conditions which, if met by a housing program, assure IRS recognition of the program as “relieving the poor and distressed.” These guidelines (and related policies), which are reviewed in detail below, now have a major effect on the way the IRS processes 501(c)(3) applications from housing organizations. However, they do not change the underlying principles set forth in the earlier Revenue Rulings.

**Moderate income households.** It should be emphasized that providing affordable housing for “moderate income” households is not recognized as a charitable activity, in and of itself, even if housing is not otherwise affordable for these households. Revenue Ruling 70-585, in its description of “Situation 4,” is clear on this point:

“An organization was formed to build new housing facilities for the purpose of helping families to secure decent, safe, and sanitary housing at prices they can afford. Its membership is composed of community organizations that are concerned with the growing housing shortage in the community. A study of the area shows that because of the high cost of land, increased interest rates, and the growing population, there is a shortage of housing for moderate income families in the community. The organization plans to erect housing that is to be rented at cost to moderate income families. The organization is financed by mortgage money obtained under Federal and State programs and by contributions from the general public.

“Since the organization’s program is not designed to provide relief to the poor or to carry out any other charitable purpose within the meaning of the regulations applicable to section 501(c)(3) of the Code, it is held that it is not entitled to exemption from Federal income tax under section 501(c)(3) of the Code.”

A combination of low and moderate income households is permitted by the safe harbor guidelines (though the term “moderate income” is not used in that context). A program may also provide housing to a mix of low and moderate income households on the basis that the program serves a charitable purpose other than that of “relieving the poor and distressed” – e.g., the purpose of “combating community deterioration.” However, the moderate income households in these cases may not be seen as qualifying for charitable benefits. In other words, they may receive housing from a charitable organization but the IRS may not recognize a basis for subsidizing the cost. Within certain limits, however, non-poor individuals may receive charitable benefits if they qualify as “distressed” on other than economic grounds – e.g., as aged or handicapped individuals. They may also receive charitable benefits through programs that qualify as charitable on the basis that they “lessen the burdens of government,” as discussed below.

## “Safe Harbor” and Related Guidelines

The IRS first set forth a “safe harbor” for organizations serving the housing needs of the “poor and distressed” in 1993 (93-1, 1993-1 C.B. 290). A more complete set of guidelines, incorporating public comments on the earlier notice, was proposed in 1995 and was then issued in 1996 as Revenue Procedure 96-32. This document describes both the “safe harbor” guidelines, by which an organization can be assured that its projects qualify as charitable, and the “facts and circumstances test” by which an organization that does not satisfy the safe harbor requirements may still qualify as “relieving the poor and distressed.” It also notes other purposes (other than “relieving the poor and distressed”) on the basis of which housing organizations may qualify as charitable.

**Income guidelines.** The safe harbor guidelines are a constructive response to a widely recognized need for clearer, more specific, and more standardized criteria for determining whether housing organizations qualify as charitable, particularly with regard to the specific income levels served. The guidelines are also a constructive response to the need for a clearer statement of how federal tax-exemption policies relate to federal housing policies, particularly with regard to housing policies supporting mixed-income projects that are not limited to low-income residents.

The first and most specific requirement for qualification within the safe harbor is that:

“The organization establishes for each project that (a) at least 75 percent of the units are occupied by residents that qualify as low-income and (b) either at least 20 percent of the units are occupied by residents that also meet the very low income limit for the area or 40 percent of the units are occupied by residents that also do not exceed 120 percent of the area’s very low income limit. Up to 25 percent of the units may be provided at market rates to persons who have incomes in excess of the low income limit.”

The terms “low income” and “very low income” are defined specifically as in the Housing Act of 1937, with low income households being those with incomes below 80% of area median income and very low income households being those with incomes below 50% of area median income as calculated, adjusted and published by HUD.

**Homeownership and the facts and circumstances test.** The safe harbor guidelines require that, “If the project consists of multiple buildings, they must share the same grounds.” It is thus clear that the guidelines are intended to be applied on a project-by-project basis, not a program-by-program basis. And, although they are not explicitly limited to rental projects, there are a number of points where it appears to be assumed that the projects in question are rental projects (or possibly coop or condominium projects). It is therefore generally better to present CLT homeownership programs in terms of the “facts and circumstances test” – and necessary to do so in the case of scattered-site single-family programs where buildings do not “share the same grounds.”

The Revenue Procedure introduces the facts and circumstances test as follows.

“If the safe harbor... is not satisfied an organization may demonstrate that it relieves the poor and distressed by reference to all the surrounding facts and circumstances. Facts and circumstances that demonstrate relief of the poor may include, but are not limited to, the following:

- (1) a substantially greater percentage of residents than required by the safe harbor with incomes up to the 120 percent of the area’s very low income limit.
- (2) Limited degree of deviation from the safe harbor.
- (3) Limitation of rents to ensure that they are affordable to low-income and very low-income residents.

- (4) Participation in a government housing program designed to provide affordable housing.
- (5) Operation through a community-based board of directors, particularly if the selection process demonstrates that community groups have input into the organization's operations.
- (6) The provision of additional social services affordable to the poor residents.
- (7) Relationship with an existing 501(c)(3) organization active in affordable housing for at least five years if the existing organization demonstrates control.
- (8) Acceptance of residents who, when considered individually, have unusual burdens such as extremely high medical costs which cause them to be in a condition similar to persons within the qualifying income limits in spite of their higher incomes.
- (9) Participation in a homeownership program designed to provide homeownership opportunities for families that cannot otherwise afford to purchase safe and decent housing.
- (10) Existence of affordability covenants or restrictions running with the property."

Among the listed factors, numbers 5, 9, and 10 are likely to be important for CLTs and should be emphasized – along with any other items that may apply – in describing the particular CLT program seeking recognition of charitable status.

**“Organization R.”** Having listed possible facts and circumstances, the Revenue Procedure then presents briefly described examples of housing organizations that illustrate the application of the facts and circumstances test. Among these examples, the following is especially important for organizations that provide or plan to provide homeownership opportunities.

“Organization R provides homeownership opportunities to purchasers determined to be low income under a federal housing program. Beneficiaries under the program cannot afford to purchase housing without assistance and they cannot qualify for conventional financing. R’s residents will have the following composition: 40 percent will not exceed 140 percent of the very low income limit for the area, 25 percent will not exceed the low income limit, and 35 percent will exceed the low-income limit but will not exceed 115 percent of the area’s median income. R does not satisfy the safe harbor. However, the facts and circumstances demonstrate that R relieves the poor and distressed.”

It is important to note not only that Organization R provides for a higher range of incomes than the safe harbor permits, but also that the range is applied to the total number of “R’s residents,” rather than to the residents of a single project on a single parcel of land. Thus it appears to accommodate a mix of incomes within a CLT’s overall homeownership program, regardless of how many sites are involved. It should also be noted that whereas the safe harbor guidelines put all non-low-income persons in a single “market rate” category regardless of any need for assistance, all of R’s residents have incomes below 115 percent of AMI, and it is not stated that residents between 80 percent and 115 percent of AMI pay market rate prices for their homes.

A number of CLTs have made very specific use of the example of “Organization R” in describing their homeownership programs within their applications for recognition of 501(c)(3) status. These CLTs have generally adopted policies that specify the safe harbor income limits for rental projects, and the Organization-R income limits for homeownership programs. In some cases IRS personnel who reviewed applications from these CLTs objected that the income policy for the homeownership program did not meet the safe harbor guidelines, but were then satisfied when it was pointed out that the mix of incomes is

what is described for Organization R in Revenue Procedure 96-32.

### **Combating Community Deterioration**

Many housing and community development programs are recognized as charitable not on the basis (or not solely on the basis) that they provide benefits to “poor” households but on the basis that they “combat community deterioration.” Rev. Rul. 70-585, in “Situation 3,” describes a community development organization that is held to be charitable on these grounds.

“An organization was formed to formulate plans for the renewal and rehabilitation of a particular area in a city as a residential community. Studies of the area showed that the median income level in the area is lower than in other sections of the city and the housing located in the area is generally old and badly deteriorated.

. . . It sponsors a renewal project in which the residents themselves take the initiative.... As part of the renewal project, it purchased an apartment house that it plans to rehabilitate and rent at cost to low and moderate income families with the preference given to residents of the area. . . .

Since the organization’s purposes and activities combat community deterioration by assisting in the rehabilitation of an old and run-down residential area, they are charitable within the meaning of section 501(c)(3) of the Code.”

This ruling (and most other rulings in which “combating community deterioration” is held to be a basis for the charitable nature of an organization’s program) is clearly limited to a geographical area where housing is already deteriorated and where median income is “lower than in other sections of the city.” Applicant organizations that claim to “combat community deterioration” may be asked to demonstrate that at least one of these conditions applies in the area where it will operate, or that specific areas characterized by these conditions will be targeted for the program in question. However, the demonstration need not be elaborate; it is often sufficient to show that the specified area has been targeted by a public agency for the use of CDBG funds or for other programs designed to aid poor or deteriorated communities.

Programs that do not limit their activities to poor or deteriorated areas will find it more difficult to gain recognition of exemption on the basis that they combat community deterioration (though they may be recognized as exempt on the basis that they serve other charitable purposes). Revenue Ruling 76-147 does recognize as exempt an organization “formed to improve conditions in an area of a city where the income level is higher and housing better than in other areas of the city.” However, the activities of this organization are limited to urging residents to clean and repair their property, providing information on home maintenance and repair, sponsoring clean-up campaigns, conducting surveys, etc. It should not be assumed that CLT activities involving active production or provision of housing in such an area would be recognized as charitable on this basis.

### **Eliminating Prejudice and Discrimination**

It can be said that eliminating prejudice and discrimination is an important goal of most CLTs, and an important effect of many CLT programs. In providing access to land and housing, CLTs remove traditional barriers raised by racial and ethnic prejudice as well as by economic factors. However, for many CLTs, it will be either difficult or unnecessary to argue that specific activities (not qualifying as charitable on other grounds) should qualify as charitable on the grounds that they serve the purpose of eliminating prejudice and discrimination.

Revenue Ruling 70-585, in “Situation 2,” recognizes as charitable an organization

which:

“constructs new housing that is available to members of minority groups with low and moderate income who are unable to obtain adequate housing because of local discrimination. These housing units are so located as to help reduce racial and ethnic imbalances in the community. . . . Preference is given to families previously located in ghetto areas. . . .”

What is important in this ruling is that it recognizes as charitable a certain kind of housing program that serves moderate as well as low income households and that operates in an area that is not characterized as poor or deteriorated. Some CLTs may have similar programs that will qualify on the same basis as the organization described here and that will not qualify on any other basis. Presumably, it will be necessary to demonstrate that these programs – and in particular their resident-selection criteria and procedures – give preference to “families previously located in ghetto areas,” or that the programs are otherwise specifically designed to eliminate prejudice and discrimination. However, many CLTs, including many serving minority communities, will find it easier to demonstrate that their programs are designed to aid low-income households and combat community deterioration than to demonstrate that certain programs are designed specifically to eliminate prejudice and discrimination.

### **Lessening the Burdens of Government**

In recent years, as a growing number of CLTs have assumed clearly defined roles as instruments of municipal or state affordable housing policies, some of them have sought and attained recognition of charitable status on the basis that their programs “lessen the burdens of government.” This possible basis for charitable status can be critically important in the case of programs that are designed specifically to address the housing needs of moderate income households and that do not qualify as charitable on the basis that they combat community deterioration or eliminate prejudice and discrimination.

In the past some CLTs argued unsuccessfully that they served this charitable purpose simply on the grounds that they reduced social problems and thereby lessened government’s responsibility for dealing with these problems. However, the IRS defines “burden of government” more narrowly. On this matter, Revenue Ruling 85-2 is commonly cited with regard to a variety of nonprofit organizations. The Ruling states:

“To determine whether an activity is a burden of government, the question to be answered is whether there is an objective manifestation by the government that it considers such an activity to be a part of its burden. The fact that an organization is engaged in an activity that is sometimes undertaken by the government is insufficient to establish a burden of government.”

To determine whether an organization’s activities do lessen an acknowledged governmental burden, we are told, “all of the relevant facts and circumstances must be considered.” In the particular case addressed by this Ruling, one kind of circumstance – the relationship between the organization and the government entity – is emphasized.

“A favorable working relationship between the government and the organization is strong evidence that the organization is actually lessening the burdens of government.”

What does this mean for a housing organization seeking recognition of charitable status for a program serving moderate income households? Clearly it will be necessary to present objective evidence (1) that a government entity considers efforts to provide affordable housing (or affordable homeownership opportunities) for households above 80% of AMI to be “a part of its burden,” and (2) that the government entity has entered into some

form of relationship with the housing organization to further these efforts and thereby lessen this burden. Potential objective evidence of such a relationship might include:

- government action to support the creation and/or operation of the organization specifically as a means of implementing the government's efforts to make affordable housing available to moderate income households..
- legislative action to fund or otherwise support specific activities of the organization that implement or support such efforts;
- a contract with the government entity, under which the organization carries out activities intended to implement or support such efforts;
- A written statement by a government official that the government has asked the organization to carry out certain activities to implement or support such efforts.

(Note that evidence of a relationship formed in an effort to make affordable housing available to moderate income households can stand as evidence not only that the organization is lessening the burdens of government but also that the government does in fact consider such efforts to be a part of its burden.)

In recent years, at least one CLT initiated by a municipal government (Irvine, CA) as a means of developing and preserving affordable housing has sought and received 501(c)(3) status *solely* on the basis that it lessens the burdens of government – without reference to the question of what income levels would receive the housing. It is also possible, however, for a CLT to gain recognition of the charitable nature of part of its overall program on the basis that it serves low-income people while gaining recognition of another part of its overall program on the basis that it lessens the burdens of government. For example, a California CLT originally created to preserve the affordability of homes built by Habitat for Humanity for very low income people was later asked by the local municipality to play a similar role in preserving the affordability of moderate income housing made affordable through the municipality's inclusionary zoning program. Having originally sought and received recognition of 501(c)(3) status on the basis that it relieved the poor and distressed, the CLT then contacted the IRS and asked that its stewardship of moderate income homes be recognized as charitable on the basis that it lessened the burdens of government, as evidenced by a letter from a municipal official explaining its request that the CLT perform this function. The request was approved.

Although “a favorable working relationship between the government and the organization” is important as evidence that the organization is lessening the burdens of government, we should be aware that not all relationships with government that can be characterized as “favorable” will assure recognition of charitable status. Any such relationship is likely to be treated as a relevant fact or circumstance but not as fully “determinative.” We should also emphasize that “participation in a government housing program designed to provide affordable housing” (see facts and circumstances listed in Revenue Procedure 96-32 above) will not necessarily be seen as indicating “a favorable working relationship” with the government. As noted above, Rev. Rul 70-585, explicitly states: “The fact that an organization receives public funds under State or Federal programs for housing is not determinative.” For purposes of determining charitable status, any set of “facts and circumstances” is likely to involve grey areas where interpretations can vary, but it is safe to say that the more distinctive an organization's relationship with government – the more it is unlike the relationships of other organizations with that government – the more likely it is that it will be seen as relieving the burdens of that government. Being one of many organizations participating in a government housing program probably will not be sufficient evidence, whereas being *the* organization designated by a government to carry out a specific function probably will be sufficient.

## Other Issues Related to Charitable Status

**Environmental conservation.** Protecting the natural environment and promoting the ecologically sound use of land and natural resources is generally a goal of the CLT model, and is generally recognized as a charitable purpose. For CLTs primarily concerned with providing affordable housing, conservation purposes may be expressed through energy-saving housing designs or through land use restrictions written into a residential ground lease, prohibiting practices that would have a harmful effect on the environment, that would waste or contaminate resources, or that would be otherwise ecologically detrimental. Such measures are not likely to have a significant effect on the CLT's tax-exempt status. They are consistent with charitable purposes, but they are not sufficient grounds for recognizing an otherwise non-charitable housing program as charitable. However, for CLTs that acquire some amount of undeveloped land with the intention of holding it in a more or less undeveloped state, environmental conservation purposes can be important.

The country's many "conservation land trusts" are recognized as tax-exempt under section 501(c)(3) on the basis that they preserve and protect the natural environment for the benefit of the public. Revenue Ruling 76-204 describes such an organization, whose activities consist primarily of acquiring "ecologically significant undeveloped land" and preserving this land with only limited use for educational or scientific purposes (or turning it over to a government agency). The organization is found to be exempt under 501(c)(3). Similar activities carried out by a CLT should be recognized as exempt as well.

The preservation of productive land (agricultural land or land used for production of forest products) raises more complicated issues, at least if the land will continue to be used for those purposes by people who are not members of a "charitable class." Revenue Ruling 78-384 finds that a certain nonprofit organization that holds farm land is not exempt, in that the farm land is not "ecologically significant" and the activity does not yield significant public benefit. Nonetheless there are 501(c)(3) conservation land trusts that do own farms and do lease them to farmers through long-term ground leases that are quite similar to CLT ground leases. The charitable purposes stated by these land trusts in these stewardship roles normally include conservation purposes that have been explicitly recognized as exempt, but they normally do not include assistance to farmers as a purpose in and of itself. CLTs with an interest in acquiring and stewarding farms or other productive land should contact established conservation or agricultural land trusts for information regarding recent experience with tax-exemption issues.

**A Note on 501(c)(2) Organizations.** Section 501(c)(2) of the Code provides tax-exempt status for organizations defined as "title holding corporations." To qualify for 501(c)(2) status, such an organization must be controlled by a 501(c)(3) organization, and its purposes must be limited to holding title to property, collecting income from this property, and turning the income over to the controlling 501(c)(3) corporation. A few regional land trusts with 501(c)(3) status by virtue of conservation purposes and activities have established title holding corporations to hold title to parcels of land that are leased to farmers or other individuals. This may be an appropriate and practical arrangement for these organizations as a way of managing such lands, but the arrangement does not allow the 501(c)(2) organization to carry out activities that would not be permissible for the 501(c)(3) organization itself. For instance, the 501(c)(2) organization could not charge a less-than-market-rate lease fees or otherwise subsidize the farmer's operation. It should also be said that, since a local organization cannot achieve tax-exempt status as a title holding corporation unless it is controlled by another corporation, it cannot operate as an autonomous, member-controlled "classic" CLT.

**Non-charitable CLT leaseholder situations.** In concluding this discussion of charitable purposes and activities, it is useful to note the range of situations in which a “charitable” CLT (as well as a 501(c)(2) organization controlled by a charitable CLT) may lease land to lessees who are not themselves members of a “charitable class” – i.e., who are not demonstrably “poor” or otherwise “distressed.”

As already noted, “moderate income” households may be among those who receive benefits from activities that can be shown to “combat community deterioration” or “lessen the burdens of government” or accomplish other charitable purposes. And up to 25% of the units in a mixed-income residential project may be rented at market rates to households whose incomes are above 80% of median (whether moderate or more than moderate). Apart from these situations, though the circumstances differ, a CLT should still not assume that it cannot enter into lease arrangements with people who are not members of a charitable class. With any such arrangements, the CLT must be able to show that the lessee is not an improper beneficiary of a charitable program, which means, for one thing, that the lessee should pay a market rate lease fee to the CLT. It should be remembered, however, that the market value of property subject to use and resale restrictions can be much lower than the market value of unrestricted but otherwise comparable properties.

Lease fees from non-charitable lease situations may not qualify as program-related income, and net income derived from these fees may be taxable. Check with your accountant regarding any such situations.

## **Public Charity Status**

**Public Charity vs. Private Foundation status.** Once a CLT meets the criteria for 501(c)(3) status, there is another distinction to be noted. Every 501(c)(3) organization is designated as either a “public charity” or a “private foundation.” This distinction is based *not* on the nature of the organization’s purpose and programmatic activities but on the nature and sources of its financial support (or on its ties with other organizations). The distinction was introduced by the Tax Reform Act of 1969, which created Section 509 of the tax code to deal with certain abuses of tax-exempt status by nonprofit entities supported entirely by one or a few wealthy parties. Section 509 imposes limits on the tax-deductibility of donations to 501(c)(3) organizations classified as private foundations and subjects these organizations to other special requirements and restrictions. There are no advantages to status as a private foundation rather than a public charity, and the disadvantages are significant.

To qualify as a public charity, a 501(c)(3) organization (other than certain kinds of institutions such as churches, schools and hospitals) must show that it meets one of several sets of tests relating to the sources of its support or show that it qualifies on the basis of its relationship to another public charity. The several ways of qualifying are stated in three separate sections of the Code: 509(a)(1), 509(a)(2), or 509(a)(3). In completing Form 1023 an organization seeking recognition as a public charity must indicate which of these sections it expects to qualify under – unless it is uncertain of whether it will qualify under Section 509(a)(1) or Section 509(a)(2), in which case it may ask the IRS to decide the proper category. Most applicant organizations should take advantage of this option and therefore may not need to concern themselves with the details of the tests described in 509(a)(1) and 509(a)(2). The following review of these sections is included for those organizations that, for one reason or another, are not sure of whether they can in fact qualify as public charities.

**Section 509(a)(1) organizations.** The most common basis for public charity status is that described in Section 509(a)(1) of the Code. Most CLTs should qualify on this basis.

Section 509(a)(1) allows organizations to qualify by passing either of two tests: the “one-third support test,” or the “facts and circumstances test.”

An organization meets the one-third support test if it normally receives at least one third of its total support from government sources and/or contributions made directly or indirectly by the general public. In applying this test, “program-related” income is excluded from total support. CLTs can assume that all income generated by their “charitable” housing programs will be treated as “program-related” income. The one third test will therefore be applied only to support from other sources, which means that CLTs with a reasonably broad base of support from dues, donations and government grants should meet the test. However, the test does involve a number of specific definitions and rules that may prevent some organizations from meeting the test. One of these is the “2% rule” described below in the quotation from IRS Publication 557. This publication can be consulted for a comprehensive review of all the relevant rules and definitions.

Organizations that do not meet the one-third test may still qualify under Section 509(a)(1) if they meet the facts and circumstances test. To meet this test, an organization must receive at least 10% of its total support from public or government sources and must maintain a program designed to attract support from such sources on a continuous basis. In applying this test, the IRS takes a number of factors into consideration (see Publication 557), and gives some consideration to the special fundraising circumstances of new organizations.

Regarding both the one-third support test and the ten-percent-of support-requirement, the following passage in Publication 557, page 32 (as of 2008) should be noted.

“Support from the general public. In determining whether the one-third support test or the ten-percent-of-support requirement are met, include in your computation support from direct or indirect contributions from the general public. This includes contributions from an individual, trust, or corporation but only to the extent that total contributions from such individual, trust, or corporation, during the four-year period immediately preceding the current tax year (or substituted computation period), are not more than 2% of the organization’s total support for the same period.”

For some organizations – particularly younger organizations dependent on a limited number of private funding sources – it may be a problem that no more than 2% of the total contributions from any one private source during the four-year period may be treated as public support (while the full amount of such contributions is included in total support). However, fundraising activities can be carried out that should allow most CLTs to meet the ten-percent-of support requirement, if not the one-third support test.

**Section 509(a)(2) organizations.** Organizations that do not meet either of the tests provided under 509(a)(1) may be able to qualify as public charities under 509(a)(2), which describes two tests, both of which must be met. The first of these is a variation of the one-third support test. In this case, gross receipts from program-related activities are *included* in both the numerator and denominator of the fraction (as part of both public support and total support), rather than being *excluded* from both as under 509(a)(1). A CLT with substantial receipts from its charitable activities (e.g., lease fees), may be able to meet this version of the one-third support test even if it cannot meet the tests under 509(a)(1). (It should be noted that the numerator of the fraction may include, from any one person in one year, no more than the greater of \$5000 or 1% of total support.)

The second test under 509(a)(2) is the “not-more-than-one-third support test,” which is met if the organization normally receives no more than one third of its support from gross investment income and unrelated business income. Gross investment income is defined as

including “interest, dividends, payments with respect to securities loans, rents, and royalties....” However, rents and fees received by a CLT for facilities or services provided in carrying out a charitable program should be treated as program-related income rather than as investment income. Most CLTs should meet the “not-more-than-one-third support test.”

**Section 509(a)(3) organizations.** Section 509(a)(3) allows an organization to qualify as a public charity not on the basis of the sources of its support but on the basis of its relationship to another 501(c)(3) public charity. 509(a)(3) Organizations (described by the IRS as “supporting organizations”) must be organized and operated to benefit or carry out the purposes of another publicly supported organization and must be supervised or controlled by or in connection with that organization. Since most CLTs are organized as independent corporations and can qualify as public charities under 509(a)(1) or 509(a)(2), they need not concern themselves with section 509(a)(3). However, anyone considering creating a CLT as an organization controlled to some degree by an existing corporation can explore, with a knowledgeable attorney, the advisability of creating a corporate structure that would qualify for public charity status as a “supporting organization.”

## The Application Process

**Fees and forms.** The Revenue Act of 1987 requires payment of “user fees” with applications for recognition of exempt status (“exempt organization determination letter requests”). As of January, 2010, the basic fee is \$850. The fee is reduced to \$400 for an organization with annual gross receipts less than \$10,000 during its first three, four, or five (or more) taxable years depending on whether it has been in existence less than one tax year, at least one tax year, or five tax years. (A CLT that expects to employ staff and launch a housing program in its early years must normally expect that its gross receipts will exceed \$10,000.) The fee for all 1023 applications using Cyber Assistant software when it becomes available (expected in 2011) will be reduced to \$200.

Form 1023 is required for the application for recognition of 501(c)(3) status. Form 1023 requires an applicant to have applied for and received an Employer Identification Number (EIN) *before* submitting Form 1023. You can apply for an EIN on line or by submitting IRS Form SS-4.

If the application is to be signed by an attorney or agent other than an officer of the corporation, you will need Form 2848: “Power of Attorney and Declaration of Representative.” (The once-separate User Fee form is now incorporated in Form 1023.) Copies of the necessary forms can be downloaded from [www.irs.gov/forms\\_pubs](http://www.irs.gov/forms_pubs). You should also download the instructions for Form 1023 and “Publication 557 Tax-Exempt Status for Your Organization.”

Don’t be discouraged by the apparent length of Form 1023. Many of the pages consist of specialized “Schedules.” Of these, you will need to complete only Schedule F. You will also need to complete and attach the checklist that appears at the very end of Form 1023.

**When to apply; late applications.** New organizations should apply within 15 months of the end of the month in which they were incorporated. Those that do not apply within 15 months may still qualify for an “automatic 12-month extension” if they apply within 27 months of the end of the month in which they were incorporated. For those who apply within this period and are recognized as exempt under 501(c)(3), the exemption will be retroactive to the date of incorporation. (For possible exceptions to these application requirements, see Form 1023, Part III.)

Most CLTs will want to apply as soon after incorporation as possible, and should immediately acquire a copy of IRS Form 1023 and familiarize themselves with the

questions that must be answered in completing the application. A number of these questions cannot be answered until a board of directors has been organized and has adopted basic program plans, budgets, and fundraising plans.

If more than 27 months have passed and your organization does not qualify for an exception or further extension of the time limit, you may still apply for exemption under 501(c)(3), but exemption can be recognized only from the date of the application (not retroactively from the date of incorporation).

Any organization that has passed the 27-month limit should, before applying, determine the possible consequences of not receiving retroactive exempt status. If an organization has not had taxable net income and if there have been no donors or grantors who would be affected by the organization's lack of 501(c)(3) exempt status for the period in which donations or grants were made, then the organization can simply apply for recognition of exemption from the date of the application.

If it is determined that donors or grantors could be significantly affected by the lack of 501(c)(3) exempt status prior to the date of application, then the organization should explore a possible further extension of the limit as noted above. If, however, it is determined that donors or grantors would not be affected but that the not-yet-exempt organization does have an income tax liability for the period prior to the date of application, then another course of action is possible. Such organizations may apply simultaneously for exemption under sections 501(c)(3) and 501(c)(4). Exemption under Section 501(c)(4) is always retroactive to the date the organization was formed. Any organization that qualifies for exemption under 501(c)(3) can also qualify under 501(c)(4), and can thereby achieve exemption from income taxes for the period prior to the date of application. (Donations to 501(c)(4) organizations are not tax-deductible.) The application for exemption under 501(c)(4) (Form 1024) is very similar to the application for exemption under 501(c)(3), so little additional work is required to complete the second application.

### Notes on Form 1023

Form 1023 has been revised periodically. A number of changes have been made in the organization and numbering of questions, but the basic concerns of the IRS, as reflected in the questions, have not changed greatly. The most important of these concerns are discussed here.

**Documents to be attached.** Note that you must submit copies of both the articles of incorporation and the bylaws. The articles must be accompanied by evidence that the articles have been duly filed with the state. Any amendments filed with the state should also be submitted. The copy of the bylaws that is submitted should incorporate any duly adopted amendments.

Make sure that the corporate name appears in the bylaws (and in Form 1023) in exactly the same form as in the articles of incorporation. Any use of abbreviations in the corporate name and spellings of all words must be consistent from one document to another.

**Narrative description of activities.** This is an important part of the application and should be written carefully. For new organizations that are not yet in position to describe actual programmatic activities, it is important to be sure that the description of *planned* activities reflects plans that have in fact been developed and approved by the board of directors.

The "operational test," as described earlier, will be applied to this description of activities. For housing organizations, including CLTs, it will normally be applied with particular reference to the "safe harbor guidelines" and "facts and circumstances test" as described in Revenue Procedure 96-32 (discussed earlier). For programs that you expect

will be recognized as exempt on the basis that they “relieve the poor and distressed,” your description should specify the mix of incomes that will be served, and should do so – as far as is consistent with board-adopted policy – in the terms used in the safe harbor guidelines (for rental projects) or in the description of “Organization R” (for homeownership projects).

To the extent that the programmatic activities do not conform to the safe harbor guidelines it is important either (1) to emphasize “facts and circumstances” that indicate the activities nonetheless “relieve the poor and distressed,” or (2) to identify other charitable purposes served by the activities, such as “combating community deterioration” or “lessening the burdens of government.” (Regarding methods of demonstrating that such other charitable purposes apply, see the earlier discussion of these topics.)

**Compensation and relationships of officers, directors, employees and contractors.** In these matters, the IRS is concerned with the possibility of earnings “inuring to the benefit of” a “private individual” through the individual’s position within the organization or relationship to someone within the organization. This does not mean, however, that individuals cannot receive reasonable compensation for labor, goods or services provided to the organization. Since CLT directors and officers generally serve without compensation and since CLT staff salaries and payments to contractors rarely, if ever, exceed the “going rate” for the positions or services involved, these questions are not likely to present problems for CLTs.

**Members and others receiving benefits.** In answering questions regarding those who benefit from the organization’s programs, most organizations that conform to the “classic” CLT model as membership corporations should make it clear that, although residents of CLT housing automatically become members, preexisting membership is not required to gain access to the benefits of CLT housing. Income requirements for the CLT’s programs should be emphasized as the primary basis for determining eligibility.

**Payments by recipients for benefits.** CLTs should state that residents of CLT housing pay for that housing as tenants or homebuyers. The explanation can generally be framed within the basic principle that “recipients” pay the after-subsidy cost of the goods or services received, and that the extent to which costs are subsidized depends on the income level and special needs of the recipients. In the event that a CLT sells or rents property to a person in circumstances where the transaction does not serve a charitable purpose, it is then important to be able to show that the person pays a market rate price or rent.

**Intervention in political campaigns.** 501(c)(3) organizations are categorically prohibited from intervening in political campaigns. A CLT’s articles of incorporation should normally proscribe such “intervention” (see Chapter 3, “Incorporation and Basic Structural Considerations”). CLT should answer no to this question.

**Activities intended to influence legislation.** 501(c)(3) organizations are prohibited from attempting to influence legislation *only* to the extent that such efforts constitute a “substantial part” of their activities. Though it is common for CLTs to attempt to influence legislation by local government relating to matters of affordable housing and community development, such efforts do not constitute a substantial part of the activities of most CLTs, and most CLTs, in completing Form 1023, can state categorically that efforts to influence legislation do not and will not constitute a substantial part of their activities.

If you are not sure whether such a statement is true, you should read the section of Publication 557 entitled “Lobbying Expenditures.” If you expect substantial lobbying expenditures, you may consider filing Form 5768 (through which procedure a 501(c)(3) organization may be allowed to make up to 20% of its exempt purpose expenditures for the

purpose of influencing legislation), but it would be wise to consult an attorney who is knowledgeable on the matter before doing so.

**Fundraising program.** Anticipated fundraising activities will have a bearing on public charity status. For new organizations a simple description of planned fundraising efforts should suffice. Most new CLTs will not use professional fundraisers, and can say so. (Employees of the organization who carry out fundraising activities as a part of their jobs are not considered professional fundraisers in this context.)

**Financial data.** Note that the Statement of Revenue and Expense and the Balance Sheet must be completed for the current year (covering a period ending within 60 days of the date of application), and for each of three, four, or five (previous or projected) taxable years depending on whether the organization has been in existence less than one tax year, at least one tax year, or five or more tax years.

For organizations that have established accounting systems, the Statement of Revenue and Expense and Balance Sheet should be completed by someone familiar with the organization's books. If an accountant has assisted in setting up the books and/or performed an audit, he or she may complete these reports for the organization. Very new organizations with minimal revenue and expenses will find it relatively simple to report the necessary information on the appropriate lines. It is understood that budgets of new organizations may need to be changed as planning continues. The fact that changes in your proposed budgets can reasonably be anticipated should not be a cause for delaying your application. Generally, CLTs have submitted year-by-year *operating* budgets – not project-by-project capital budgets – and have attached a note explaining that the operating budget does not include amounts that are being or will be invested in acquiring and developing real estate.

**Public charity vs. private foundation status.** See the discussion of “Public Charity Status” above. Most CLTs can reasonably expect to be ruled public charities rather than private foundations. Unless you have reason to be sure that your organization cannot qualify as a public charity through any of the sets of tests discussed above, you should answer “no” to the question of whether you are a private foundation. Most CLTs will qualify as public charities under either section 509(a)(1) or section 509(a)(2), and can check the box indicating that they want the IRS to decide which of these sections will apply.

**Follow through.** After you have submitted your application to the appropriate IRS office, you will receive an acknowledgment, with an indication of when you can expect the application to be processed. The waiting period varies, depending on the number of applications waiting to be processed.

Once processing of your application begins, you may receive a request from the IRS for additional information. The request normally entails a list of questions – sometimes a rather long list. The questions may appear to overlap each other substantially or to ask for information already provided. Nonetheless, it is important to answer the questions, one at a time, thoroughly and precisely (and to do so within the time allowed). The answers should be prepared by the person who has prepared the original application, or, at least, by someone who is familiar with the original application and understands the distinctions on which 501(c)(3) status depends. Answers that are overly general may result in yet another set of questions from the IRS.

Once the office that initially processes the application believes that it has all of the necessary information, one of two things will happen. Usually the office will make a determination on your organization's status (and issue a “determination letter”), but if it still has questions about how to deal with your application it may refer it to the Washington,

D.C. office of the IRS. In the latter case, it is possible that the Washington office will ask for still more information before finally making a determination.

Most organizations achieve recognition of 501(c)(3) status relatively quickly and easily. For a few it proves to be a time-consuming process. The difference is due not only to differences among applications but to differences in the understanding and experience of IRS personnel. If the process is time-consuming for your organization, do not be discouraged. Do not be intimidated by the number of questions asked. Follow through. 501(c)(3) status will become increasingly important for your organization as it develops. If you do not follow through with your initial application, you will need to begin the process all over again in more complicated future circumstances.

## CHAPTER 7

# LAUNCHING OPERATIONS

This chapter provides a review of the subjects that a new CLT must address, following incorporation, as it “sets up housekeeping” and begins developing its program. We assume that some important “initial choices” (as discussed in Chapter 2, “Initial Choices”) have already been made by an “organizing committee” prior to incorporation. In particular, choices should have been made relating to basic goals, service area, formal relationships with other institutions, and governance structure (whether a classic CLT structure or an alternative structure). We further assume that the committee has reached agreement on draft bylaws designed to implement the intended governance structure, though formal adoption of these bylaws cannot take place until the organization is incorporated (see Chapter 4, “CLT Bylaws Considerations,” and Chapters 5-A and 5-B regarding classic CLT bylaws).

### Setting Up Housekeeping

**Initial directors and initial meetings.** Upon incorporation, the CLT’s initial board will consist of those people named as initial directors in the articles of incorporation – who will normally be people who have participated in the work of the organizing committee and are committed to the goals and structure approved by the committee. The initial board is responsible for the corporation until a “permanent” board is elected, but its specific duties are limited to the process by which the corporate membership and permanent board are to be established. In the case of classic CLT corporations, these duties are (1) to formally approve the previously drafted bylaws, (2) to schedule the first annual meeting of the membership, (3) to select and present a slate of candidates for the “permanent” board, to be elected by the members at the first annual meeting, and (4) to present the bylaws for final approval by the membership (see Chapter 5-A, “Model Classic CLT Bylaws,” Article XI). In the case of non-membership corporations, the duties of the initial directors will be to schedule and carry out a meeting of themselves to formally adopt bylaws and nominate and elect the members of a “permanent” board. In any case, the initial board should be seen as a bridge to the intended permanent governance structure and should be expected to accomplish this function as quickly as is practical.

**First elected board of directors.** In order to assure continuity of planning from the “organizing committee” to the first duly elected board it is generally wise to see that a substantial portion of the nominees for board seats are drawn from among the participants in the “organizing committee.” It is also wise, however, to take the opportunity at this time to “round out” this board by recruiting others who can represent significant groups or institutions not otherwise represented, or who can provide types expertise not otherwise included.

Once elected, the “permanent” board must hold an “organizing meeting” to elect officers in accordance with its bylaws, to take steps to establish committees, and to agree on an ongoing schedule of meetings. The number of committees and the scope of work assigned to each can vary from one organization to another, but the start-up concerns that you are likely to want one committee or another to address include:

- staffing, budgeting, accounting
- design of resale formula and other aspects of ground lease
- program planning
- outreach and resource development

If, as is likely, some of the members of the new board have not participated in the work of the organizing committee and are new to the CLT initiative, you should plan to schedule an orientation session for the full board, to introduce the newly elected directors to each other and to brief new participants on the planning done by the organizing committee.

**Necessary groundwork for financial management.** Before the new organization can receive funds, employ staff, or disburse money to cover other basic start-up expenses, certain tasks must be completed as soon as possible.

*Application for EIN.* The corporation will need to have an Employee Identification Number (EIN) assigned to it before it can complete a number of necessary tasks, including the simple task of opening a bank account. The application process can be completed quickly. You can file IRS form SS-4 by mail, or you can apply on line.

*Opening bank accounts.* The organization will obviously need at least a checking account before it can begin doing business of any sort. If it already has a commitment of funding from some source and expects to receive a significant lump sum from that source in the near future, the organization will probably want to open an interest-bearing holding account as well as a checking account. Before accounts can be opened, the CLT board will need to authorize certain people (perhaps initially just President and Treasurer) to sign checks or withdraw funds. The choice of a depository institution in which to open accounts may be influenced by immediate practical considerations, but it may also have long-term strategic significance for the CLT, which has a necessary interest in building a positive relationship with financial institutions from which it may eventually seek project financing or mortgage financing for CLT homebuyers.

*Establishing an accounting system and bookkeeping process.* Before the organization can receive or disburse funds, systems must be put in place to record and account for every transaction. Initially these will be simple transactions (receiving grants and/or donations, purchasing office equipment, paying staff). A relatively simple accounting system would suffice if it were not for the fact that in the future the CLT will need a much more sophisticated system. Over the longer term, the organization will be acquiring multiple parcels of real estate. In many, if not most cases, it will be improving (adding value to) this real estate, then selling part of each parcel (the home) while retaining ownership of the land. It is also likely to receive multiple loans on various terms and to repay them over various periods of time. And it is likely to receive various grants or deferred loans that are restricted to specific projects and cannot be used otherwise.

Accounting for this interwoven inflow and outflow of monetary value is not simple, and the consequences of failing to account for it fully are serious. A CLT that begins with an unsophisticated accounting system and does not deal with the question of how to adapt that system to future complications until it finds itself already in the midst of those complications is asking for trouble. It is therefore essential, before setting up any accounting system at all, to consult with a qualified accountant – one who is at least

familiar with nonprofit accounting, and preferably one who is familiar with the accounting needs of nonprofit housing organizations. You will want expert advice not only regarding the kind of accounting system that will suite your long-term needs, but regarding the computer software that will best accommodate that system. And you will want to begin using that system and that software as soon as possible.

*Budgeting.* Before the new organization hires staff and makes other start-up financial commitments, a first-year operating budget – or perhaps several alternative versions of a first-year budget – should be developed. The process will require making an objective projection of income – or multiple projections contingent on different assumptions. Multiple expense projections based on differing assumptions (e.g. part-time staff vs. full-time staff) may also be useful. In any case, the budget – or each contingent budget – should be one in which expenses do not exceed income. The budget can be modified during the year, as the level of income for the year becomes more certain, but it is important to work through the budgeting process as objectively as possible at the outset so as to have a clear idea of how much can be spent under different circumstances.

*Application for tax exemption.* To gain access to needed resources, the CLT should, as soon as is feasible, complete an application to the IRS (Form 1023) for federal tax-exemption under section 501(c)(3) of the tax code. However, the application cannot be submitted immediately following incorporation, since it must contain operating budgets and, most importantly, a program description based on a planning process of the sort described below (see Chapter 6, “Tax-Exemption”). Once the IRS has recognized the organization as exempt under section 501(c)(3), the CLT can normally also seek exemption from state and local sales taxes. CLTs normally do *not* seek exemption from property taxes for CLT homes, but may need to see that these resale-restricted homes are not assessed for what their market value would be *without* resale restrictions (see Chapter 17, “Property Tax Assessments”).

*Personnel policy and employer responsibilities.* Before advertising an initial job opening – and as the budgeting process progresses – the organization should develop a basic set of personnel policies. Candidates for the initial staff position will want to know not only what salary will be paid but also what benefits will be provided, what vacation, holiday, and sick-leave privileges will be offered, what evaluation procedures will be followed, and so on.

Also before hiring staff, the organization must inform itself regarding its responsibilities as an employer and be prepared to comply with all applicable federal and state law – including responsibility for withholding and depositing payroll taxes and making payments for unemployment insurance.

**Initial staffing.** Some CLTs operate initially on an all-volunteer basis, without staff. Sooner or later, however, staffing will be required to develop and sustain an effective CLT program on even a very modest scale. *Sooner* is generally preferable to *later*, but, at the same time, nothing is more important than the quality of initial staffing. Organizations whose first employee “doesn’t work out” inevitably suffer a loss of spirit, credibility and momentum. It is therefore important to approach the hiring process with all due deliberation.

*Job descriptions and qualifications.* For some new organizations the first and most difficult staffing question may be whether to define the initial position as that of

executive director and to try to fill that position with someone who has long-term executive director potential, or whether to describe the initial position in terms of the more limited administrative skills that should be sufficient for the short-term. The latter approach is probably safer, as well as entailing less immediate expense for a new organization. If the person hired into the more limited position proves especially effective, he or she can eventually be designated as executive director, but the organization will also be free to consider other candidates for that position. Nonetheless, the most successful organizations are often those that, at the outset, were smart and/or fortunate enough to hire a strong executive director who invested him-or-herself fully in building the organization from the start. In any case, a new organization should give careful thought to the question of which approach it will take, and then develop a job description for one or the other type of position – or, better yet for both positions, even though only one will be filled initially.

Suggested below are some basic qualities that most CLTs would look for in filling the respective positions – though you will not necessarily find all of them in any one candidate.

*For the administrative position:*

- Competence with basic office equipment, information technology, and, in particular, common computer applications.
- Ability to communicate clearly, both orally and in writing.
- Basic understanding of the CLT model and ability to communicate it to others.
- Basic understanding of bookkeeping procedures.
- Familiarity with the local community and its institutions.
- Efficient work habits and reliability.

*For the executive director position:*

- A clear understanding of, and strong commitment to, the CLT model and shared equity homeownership.
- The ability to write and speak persuasively.
- The ability to interact effectively with a variety of people.
- Experience in nonprofit management, including supervision of other staff.
- Understanding of basic accounting concepts and financial management practices.
- Experience with affordable housing programs (and, in particular, affordable homeownership programs) and familiarity with the government programs through which affordable housing is subsidized.
- Familiarity with existing housing and community development programs in the local area, and local government programs that interact with them.
- Basic competence with common computer applications.
- Willingness to work the extra hour (or more) when it is needed.

## **Program Development**

A greater or lesser amount of program planning – including resale formula design in some cases – may have been done by the organizing committee prior to incorporation. Even if a substantial amount of planning has already been done, however, the new corporation’s board of directors will now need to review the earlier plans, confirm them, work out remaining details, and develop plans for implementation.

**Resale formula design and lease development.** The CLT ground lease and the resale formula embedded in it represent a relatively complex body of requirements and restrictions that will affect both the CLT and its lessee-homeowners in major ways far into the future. The development of the resale formula and ground lease should therefore be done with great care and due deliberation. This does not mean, however, that the process should be put off until later. As soon as a new CLT begins to describe its approach to “resale-restricted homeownership” to others in the community, there will be questions about exactly how and to what extent resale prices will be restricted and in what other ways the benefits and responsibilities of homeownership will be affected by the lease. These questions cannot be fully answered until the CLT has decided what formula it will adopt to limit resale prices and how its lease will deal with certain other sensitive issues. Consideration of these issues should therefore not be deferred.

The basic aspects of the CLT ground lease are discussed in Chapter 10, “Legal Issues re. CLT Ownership.” The Model CLT Lease is presented in Chapter 11-A. Section-by-section commentary on the Model (including discussion of alternative approaches taken by some CLTs in some sections) is presented in Chapter 11-B. The subject of resale formulas – including the advantages and disadvantages of the various types of formulas used by CLTs – is discussed in some detail in Chapter 12, “Resale Formula Design.”

Some new CLTs may be tempted to avoid spending the time needed to think through the various tradeoffs involved in designing a resale formula and other lease provisions. Some may believe that simply adopting the formula and other lease provisions used by an established CLT with a successful track record will be a practical way to bypass a complex subject. But there are two serious problems with this approach. First, there is no one-size-fits-all resale formula design: different formulas are used by different CLTs for significant local reasons (e.g., differing market conditions, differing types of housing). To adopt another CLT’s formula without knowing why it was adopted by that CLT and without considering exactly how it would work in your own situation would be foolish. Secondly, the detailed consideration of different formulas and alternative approaches to certain other lease provisions is a necessary foundation for the long-term application and (when necessary) *defense* of whatever approach is finally adopted. A CLT’s redefinition of the rights of homeowners is likely to be challenged by some in the community. In responding to such challenges, the CLT should be prepared to explain exactly *why* its homeowners’ rights are defined in the way that they are. Simply to say that your approach was borrowed from a different organization in a different community will not be a persuasive response for some.

Much of the necessary deliberation will be focused on resale formula design, but other ground lease issues must also be addressed in the process of adapting the Model Lease to a particular CLT’s goals and circumstances. The following list identifies some of the more significant questions that should be addressed in certain sections of the model. Discussion of the questions can be found in the commentary on those sections.

- *Use restrictions* (Section 4.1): Exactly how should your lease define permitted uses of the CLT home and leased land?
- *Occupancy requirement* (Section 4.4): All CLTs require owner-occupancy, but how should occupancy be defined in stating this requirement?
- *Inspections* (Section 4.6): When and how and in what ways should the CLT have a right to inspect the home and leased land?

- *Lease fee and replacement reserve* (Section 5.1): What should be the amount of the monthly fee and should it include a “replacement reserve fee”?
- *Homeowner’s right to select a buyer* (Section 10.6 version 2): Should the homeowner have a right to sell to an income-qualified buyer of her choice, or only to *recommend* a potential buyer to the CLT?
- *Transfer fee* (Section 10.12 or 10.13): It is recommended that the Lease permit the CLT to charge a “transfer fee,” but what should be the maximum amount permitted?

**Program design.** Some fundamental program design questions are discussed in Chapter 2, “Initial Choices,” and these may have been addressed in greater or lesser detail by the organizing committee prior to incorporation. The CLT’s duly elected board of directors should now confirm whatever “initial choices” have already been made and should translate these choices into a work plan for the initial year, with longer-term program goals also clearly defined. It is important that this planning be done *before* specific projects are launched and specific properties acquired. The CLT should be prepared to resist the temptation to undertake initial projects simply because certain properties happen to be available on what seem to be favorable terms. To be sure, there is a place for opportunism in a CLT’s selection of projects over the long term, but *initial* projects will define the nature and future direction of the CLT’s work in the eyes of the community and should therefore represent the CLT’s longer-term intentions, not just present opportunity.

The program plan adopted by the board at this time will be an important part of the proposals that will be submitted to funding sources (and the plan’s implementation will in turn be dependent on the persuasiveness of those proposals). The plan will also be the necessary basis for the program description that is a critical component of the application for recognition of federal tax-exemption. The application cannot be submitted before the board has adopted a plan. (See Chapter 6, “Tax-Exemption.”)

Specific points that will normally be covered in an initial program plan include the following.

- *Geographical target area* Chapter 2 discusses considerations involved in defining the overall geographical area that a CLT will be organized to serve. This service area may be more extensive, however, than the specific area targeted, for strategic reasons, in the CLT’s initial work plan.
- *Intended income level.* The CLT’s earlier, more general planning may have defined the organization’s purposes in terms of service to low and moderate income people, but this does not mean that the initial work plan will necessarily address the needs of this wide range of household incomes. You may have reasons, for instance, to focus first on housing for low-income households (see Chapter 18, “Project Planning and Pricing”). It should also be noted that the particular mix of low and moderate income households served can have a major effect on the CLT’s eligibility for 501(c)(3) tax exempt status (again see Chapter 6, “Tax-Exemption”). In any case, you will want to determine what “low-income” (usually defined as below 80% of area median income) and “moderate income” (usually defined as between 80% and 115% or 120% of area median income) actually mean in terms of annual household income, as adjusted for household size by HUD, for the area in question.

- *Intended subsidy sources.* The guidelines governing the use of specific subsidies – as well as the amounts of subsidy potentially available – must be recognized. The intended income level and other aspects of the plan must fit within these guidelines (e.g., federal HOME funds can be used to subsidize low income but not moderate income housing).
- *Roles of CLT and intended partners.* It may be that at least in its initial program the CLT will not be the developer of housing but will assume the long-term stewardship role for homes developed by others (possibly including homes built or rehabbed by CDCs or Habitat for Humanity chapters, or perhaps “inclusionary” units built by for-profit developers). In such cases it will be important to determine what role, if any, the CLT will have in marketing the homes. In any case it will be important to define the CLT’s role in orienting homebuyers regarding the nature of CLT ownership. If the CLT *is* to be the developer (either rehabbing existing homes or building new ones), the planning process will need to cover a great many issues, including site-selection, design issues, project financing issues, construction oversight, marketing and homebuyer assistance.
- *Housing type and ownership model.* Decisions regarding housing type and ownership model are likely to be influenced by the intended income level and the particular subsidies sought. In some expensive markets, for instance, it may be that the only homes that can be made affordable with the available subsidy will be condominium units (see Chapter 14, “CLTs and Condominiums”). In situations where the CLT plans to acquire and rehab existing homes, its program will of course be shaped by the nature of the existing homes that are available.
- *Initial project feasibility assessment.* As the planning process addresses the variables noted above, it will be important to test the financial feasibility of different combinations of those variables. For instance, if the CLT considers building or rehabbing homes to be sold to low-income households in a particular neighborhood, with available per-unit subsidy limited to a particular amount, it will be necessary to estimate total per-unit acquisition and development costs for the anticipated type of project, then subtract the anticipated subsidy from the total project cost to determine the price for which these homes could be sold, then calculate whether the monthly income of the intended low-income buyers can cover the debt service that will be required if most of the purchase price is financed at current interest rates. Cost estimates may be rough at this stage of planning, but feasibility assessments of this type should allow the CLT to determine (and to demonstrate to funders) what is and is not feasible.

## **Outreach and Fundraising**

Outreach efforts should be carried out at the same time as the planning efforts described above, and should inform those efforts in various ways as the CLT determines what resources and what types of partnerships may be available to it. Outreach is important for several reasons. Because the CLT approach to homeownership is unfamiliar to most people, a new CLT must make a serious effort to educate the general public regarding this approach. Because it is likely that other affordable housing and community development organizations are already working in the area, it will be important for a new CLT to reach out to these organizations and explore ways it can

cooperate with them, rather than compete with them. And because outreach is the necessary first step in the effort to mobilize the financial resources necessary to an affordable housing program (including operating support, homeownership subsidies, and appropriate homebuyer mortgage financing), a new CLT must reach out to foundations, public agencies that allocate subsidies, and mortgage lenders.

**Outreach to the general public.** Educating the public about the CLT and building public support for the CLT's programs will require an ongoing effort. In later years the effort can focus on what the CLT is accomplishing – successful projects, successful homeowners who could not otherwise have afforded homeownership – but initial outreach to the public will need to present the CLT's basic goals and basic approach to homeownership in terms that will be comprehensible to potential lower income homebuyers and other lay people. Your goals will be, first, to persuade lay people that the CLT will be good for the community and possibly for themselves as individuals, and, secondly, to persuade funders, lenders, and housing professionals that the CLT has the ability to communicate the CLT concept successfully and win acceptance of it.

It is crucially important to develop written materials that describe the CLT and its goals clearly, persuasively and consistently. Keep the basic explanation as simple as possible, and do not try to vary the way it is presented too much from one situation to another. The explanation that appears in your press releases should be essentially the same as what appears in your brochure and your web site and should provide the foundation for oral presentations and interviews with media representatives (who should always receive a copy of your basic written statement so they won't be completely dependent on their notes). Keep your oral statements to assembled groups and the media "on message." Don't try to say too much or to make your basic points in too many different ways. Multiple explanations employing different terminology will invite garbled reports of what has been said.

**Outreach to existing housing organizations.** As is emphasized in Chapter 2, "Initial Choices," contacts with other nonprofit organizations that are already working in the field that a new CLT plans to enter should be made early in the process of pre-incorporation planning. Following incorporation, when the CLT's presence in the field has become a fact, outreach to these organizations should obviously continue – with a focus now on developing specific cooperative relationships. If other nonprofit organizations are building homes that are subsidized and sold to low-income people, you will certainly want to explore the possibility of these homes being sold through the CLT program, with the CLT taking title to the land and preserving affordable owner-occupancy for the long term.

An established nonprofit developer may or may not like the idea of seeing these homes sold on terms quite different from what the organization is used to, but there are reasons why it may be in the organization's interest to consider the possibility – especially if the CLT can relieve it of the burden (at least in part) of marketing these homes and the financial risk of perhaps having to hold completed homes while seeking a buyer. And it is certainly in the interest of a new CLT to take advantage of existing housing development experience and expertise, and very much in its interest to avoid competing with an affordable homeownership program that utilizes the same subsidies the CLT would utilize but that sells these subsidized homes *without* long-term resale restrictions. A CLT's relationship with such an organization may be structured in several

ways – perhaps with the other organization in the role of “turn-key” developer, owning the land while building on it, then turning the developed property over to the CLT, or perhaps with the CLT owning the land during development and contracting with the other organization to carry out construction.

The new CLT will also have an interest in utilizing an established nonprofit homebuyer training and counseling program rather than trying to develop its own program to familiarize low-income people with the process of buying a home and to help them qualify for mortgage financing. Particularly if the nonprofit that operates the program will agree to work with the CLT to include a CLT component in its training, the CLT will not only be relieved of the need to develop a comprehensive homebuyer training program of its own, but may also be aided by the existing program in bringing CLT homeownership opportunities to the attention of a larger group of potential low-income home buyers. (Even with the help of such a program, however, the CLT should still expect to provide CLT-specific information and training to its own homebuyers. See Chapter 21, “Marketing, Buyer-Assistance, Buyer-Selection.”)

**Approaching government funders.** No CLT program can accomplish a great deal without access to funding from government agencies to provide the necessary initial subsidy for CLT homes and to help support CLT operations. Initial contacts with all potential sources of government support in the CLT’s service area should have been made during pre-incorporation planning. Following incorporation, communication with these sources should increase as program planning proceeds. If agency personnel are interested, you can invite them to sit in on planning sessions and offer their perspective on what may or may not be fundable under their program guidelines.

Probably the most common source of funding for CLT programs is the federal HOME program (established by the Housing and Community Development Act of 1990), which provides block grants for affordable housing to state and local governments. Larger municipalities or consortia of local governments qualify for direct grants as local “Participating Jurisdictions,” or “PJs.” Housing organizations within a local participating jurisdiction apply to the PJ for funding. Those not within a local PJ can apply to the state for funding under HOME-funded programs maintained by the state.

An important feature of the HOME program – especially for CLTs – is the requirement that at least fifteen percent of a PJ’s HOME funds be invested in housing “developed, sponsored or owned” by “Community Housing Development Organizations,” or “CHDOs” (pronounced *Chodo*). CHDOs can also receive operating support from a PJ’s HOME funds. In 1992, federal legislation included a formal definition of the community land trust model and specified that such organizations qualify for CHDO status under the HOME program. This status is not automatic, however. The PJ must formally designate the CLT as a CHDO – and it is very much in the interest of a new CLT to seek this designation as soon as possible. (See Chapter 4, “CLT Bylaws Considerations,” regarding details of CHDO status for CLTs.) For CLT-CHDOs that have a positive relationship with a local PJ, the HOME program can be a relatively predictable source of support from year to year.

The other important federal block grant program – the Community Development Block Grant (CDBG) program – can also be used to support housing programs (including operating support) as well as a wide range of other community development activities. Other state and local programs – varying from jurisdiction to jurisdiction – may offer

funding possibilities for the CLT as well. For a new CLT, it is obviously important to identify all possible sources, learn how funds are currently being allocated by each source, and determine what must be done to qualify for funding from each source.

**Approaching foundations and other private grantors.** No one private grant-making institution is likely to be a regular, ongoing source of support for a CLT homeownership program, but private grantors can be a significant source of start-up support for a CLT (as well as support for various specialized projects in later years). These institutions include grant-making programs established by banks and other for-profit institutions (typically funding activities in the areas where they do business), as well as local and regional foundations, including “community foundations.” Major national foundations are not a likely source of support for local CLT start-ups except in major metropolitan areas and/or areas where an exceptional need is recognized (e.g., the Ford Foundation has funded efforts to launch CLTs in post-Katrina New Orleans). A new CLT should compile a list of all grant-making institutions that have funded, or might fund, programs serving the geographical area served by the CLT, and should assemble available information about the particular interests of each institution, the approximate dollar amounts of grants that each makes, the funding cycle of each (when proposals are accepted and when grant decisions are made) and any available information regarding proposal guidelines. The CLT should then send a formal letter of inquiry to all of the institutions where there appears to be any possibility of funding – and/or contact them by phone, or in person where personal contact is possible.

Unlike the public agencies that deal specifically with housing and community development matters, private grant-makers are likely to fund a wide range of charitable, educational, artistic, and environmental activities, and most of them cannot be expected to know a great deal about the housing issues the CLT addresses. Therefore, in writing letters of inquiry and grant proposals for these funders, the CLT should first develop a persuasive account of the community’s need for affordable homeownership opportunities for lower income people (backed up by relevant local statistics). The CLT’s letters and proposals should then emphasize the ways in which most conventional affordable homeownership programs fail over the long term, and should then explain how the CLT does what other programs fail to do. A basic “generic” proposal should be developed, which can then be adapted to fit the particular proposal guidelines of each funder.

**Outreach to lenders, attorneys, realtors, and other professionals.** Over time, in its various real estate transactions, a CLT will need the services and cooperation of individuals and firms that deal professionally with various aspects of real estate. In its start-up phase a CLT should make a point of introducing itself to these people. All of them can be expected to be interested in how the CLT model works, what the new CLT plans to do in the local community, and how they might expect to interact with the CLT in their professional roles. Relevant professional groups include the following.

- *Mortgage lenders.* Mortgage lenders will play a crucial role in any CLT homeownership program. The CLT’s homebuyers will need mortgage financing of a type – leasehold mortgage financing – with which most lenders will have had little or no prior experience. It is important that the new CLT begin discussing this subject with them long before the first CLT homebuyer applies for a loan. Chapter 20, “Financing CLT Homes,” provides detailed information on this subject.

- *Attorneys.* The CLT will not only need legal counsel in its own right; it will also need to identify attorneys who are interested in the CLT approach to ownership and are willing to familiarize themselves with the CLT ground lease and provide legal counsel regarding the lease and related documents to CLT homebuyers (see Article 1 of the Model Lease and related commentary re. the “Attorney’s Letter of Acknowledgement”).
- *Realtors.* Some CLTs work directly with real estate brokers in selling CLT homes; others may interact with realtors in connection with “buyer-initiated programs” (see Chapter 21, “Marketing, Buyer-Assistance, Buyer Selection”). And it is in the interest of all CLTs to cultivate a friendly relationship with the local realtor community, which is positioned to help the CLT in a variety of ways. It is important that these professionals understand the CLT’s goals and methods.
- *Appraisers.* Appraising the market value of resale-restricted CLT homes on leased land involves issues with which many (though not all) real estate appraisers are unfamiliar. It is important to explore these issues with at least some local appraisers as soon as possible (again see Chapter 20, “Financing CLT Homes”).
- *Insurance agencies.* The CLT will need various types of insurance for the various types of property interests that the organization and its homeowners will have. Preliminary discussions with agencies that might provide appropriate insurance should not wait until the day the CLT acquires its first property and needs insurance on that property right away.

## Chapter 8

# Implementing Restrictions on Ownership

The community land trust approach to affordable homeownership is one of a number of approaches employed by programs that subsidize the cost of homeownership for low or moderate income people who could not otherwise afford to purchase homes. Although, in the past, such programs sometimes provided subsidies without imposing any obligations or restrictions on the homeowner-beneficiaries, the trend has been toward programs that do at least require that the owners repay the subsidy when they sell the home – at least if they sell before a specified period of time has passed. In the view of a growing number of people, however, these subsidy-recapture provisions do not go far enough. They subsidize individual purchases, one at a time. The practice therefore requires that a new (and often larger) subsidy be applied each time a home is sold. CLTs occasionally have no alternative but to utilize funding programs that do entail subsidy-recapture (see Chapter 19, “Subsidy Structure”); however, the goal of the CLT is not to recapture subsidies in this way but to establish long-term restrictions on ownership that will be passed on from owner to owner and, it is hoped, will assure continued affordability without the need for new subsidy.

This chapter reviews four basic types of restrictions on ownership that are essential to CLT programs and that are coming to be implemented by a growing number of non-CLT programs as well. (Affordable homeownership programs, including CLTs, that limit ownership in these ways have come to be known collectively as “shared equity homeownership” programs.) The chapter then reviews the various legal devices and ownership models used to establish these restrictions. Finally the chapter explores in greater detail the relative strengths and limitations of the two methods of establishing restrictions that are of greatest importance for CLTs – ground leases and deed restrictions.

### Types of Restrictions

These restrictions can be established to restrict the ownership of any type of real estate, but we will discuss them here as they are used by CLTs and others in typical affordable homeownership programs. Briefly, the four types of restrictions are:

- *Resale price restrictions*, designed to preserve the affordability of homes for specified groups.
- *Buyer-eligibility restrictions*, designed to see that when affordable homes are resold they will be sold to members of the intended group.
- *Occupancy and use restrictions*, designed to assure the direct use of the home by the intended group for the intended purposes and to preserve the quality of the land and improvements for future users.
- *Restrictions on mortgage financing*, designed to protect owners against predatory lenders and to assure that the future availability of the property for the intended group is not lost through mortgage foreclosure.

**Price restrictions.** Resale price restrictions limit the price for which a property can be sold, with the intention of keeping the price affordable for households of a designated income level. Affordability is normally measured in terms of the amount of mortgage payment that a household with a given income can afford, in addition to taxes and insurance (and lease fee in the case of CLT homeowners), assuming that a high percentage of the purchase price is

mortgage-financed (usually at least 95%). The price restrictions usually allow the homeowner, when she sells, to recoup her original investment plus a limited amount of appreciation determined by one or another type of “resale formula.” (See Chapter 12, “Resale Formula Design,” for a full discussion of the various types of formulas.) When an owner wants to sell, the restrictions are enforceable through a “preemptive option” that allows the CLT or other sponsoring agency to purchase the property for the lesser of the formula-based price or the property’s appraised value. (It is important to distinguish clearly between such *price restrictions*, which result in “below-market” prices, and *subsidy-recapture* requirements, which allow a property to be sold for a full market price, out of which the subsidy is then to be repaid.)

**Buyer-eligibility restrictions.** These restrictions determine what categories of people will be permitted to buy a home when the owners want to sell it. Programs designed to provide homeownership opportunities for lower income households typically limit subsequent, as well as initial, buyers to those households that have incomes in the range targeted by the program. Homes may be sold, for the restricted price, either directly to “income-eligible” households or back to the CLT or other sponsoring agency for subsequent resale to income-eligible households. Maximum incomes for eligible buyers are usually defined in terms of percentages of area median household income (AMI) for the geographical area in question, adjusted for household size by HUD.

**Occupancy and use restrictions.** Programs designed to provide affordable owner-occupancy opportunities for lower income households have reason to require that owners (subsequent as well as initial owners) do in fact occupy the homes they own as their primary residences. Occupancy restrictions thus prohibit absentee ownership and require that an owner who moves out of a home must sell it. Other types of use restrictions include those that require proper maintenance and prohibit uses that would diminish the quality of the homes for future residents or that would be detrimental to the surrounding community. (For example, see Article 4 of the Model Lease in Chapter 11-A) In the case of homes that include one or more rental units in addition to the units occupied by the owners, restrictions may require that tenants meet certain income-eligibility requirements and that the rents not exceed affordable levels.

**Mortgage financing restrictions.** These restrictions limit the types of mortgage (or deed of trust) that an owner can grant as security for a loan. Typically they require approval of a mortgage by the CLT or other sponsoring agency, and often they require that the mortgagee agree to give the sponsoring agency certain rights to intervene, in the event of a default, to prevent foreclosure. (See Article 8 of the Model Lease.)

## **Methods of Establishing and Enforcing Ownership Restrictions**

In this section we will offer an overview of the various kinds of legal mechanisms that *can* be used to establish the kinds of restrictions identified above. In the next section we will focus on the relative strengths and limitations of the two mechanisms – deed restrictions and long-term leases – that are commonly used by CLTs.

**Deed Restrictions.** Deed restrictions (also known as deed covenants) are attached to the deed of a property and are written in terms that will bind subsequent as well as present owners of the property. The specific provisions can vary from very simple restrictions to very elaborate sets of restrictions and requirements. Deed restrictions have been common

with homes in subdivisions where developers have wanted to prevent buyers from modifying such things as the color, size or shape of their houses in ways that might offend the conventional expectations of their neighbors, and they have come to have an important role in the various forms of “common interest ownership,” such as condominiums.

In recent years deed restrictions have also become increasingly common as ways to preserve affordability and other intended effects of affordable homeownership programs. Restrictions attached to the deeds of homes developed or sponsored by such programs can give a preemptive option to the developer or sponsoring agency, allowing that entity either to purchase the home for a limited price when the owner wants to sell or to see that the home is sold to a household at a specified income level for a price not exceeding the purchase option price. The occupancy, use, and financing restrictions noted above can also be established as deed restrictions.

As will be discussed in greater detail below, the long-term enforceability of deed covenants varies from state to state, and in some states is specifically limited by statute (e.g. to 30 years) or is more broadly limited by the common law “rule against perpetuities.”

Resale restrictions attached to a deed are sometimes said to be “self-enforcing,” in that a title search should bring them to light when a property is to be sold, and a potential buyer, once aware of the restrictions, would not be likely to proceed with a transaction that violated them. As will be discussed below, however, enforcement is not assured in actual practice – and occupancy and use restrictions are not likely to be enforced at all – unless some agency is actively monitoring compliance.

**Collateral agreements.** Rather than attaching restrictions directly to the deed, the seller may require the buyer, at the time she purchases the home, to sign a separate document agreeing to the limitations in question. Such agreements have the advantage of documenting an owner’s explicit consent to the restrictions in question. However, the long-term enforceability of collateral agreement is subject to many of the legal limitations that make the use of long-term deed restrictions problematic. And, as with deed restrictions, the likelihood that collateral agreements will actually be enforced depends on active monitoring and enforcement measures by some agency.

**Mortgages.** Mortgages (or deeds of trust) are a very common means of enforcing the subsidy-recapture provisions mentioned above. Where a subsidy is structured as a deferred loan, a mortgage is a reliable means of seeing that when the property is resold, the loan will either be repaid or passed on to a purchaser who assumes the mortgage.

Mortgages can also be used to enforce resale and use restrictions. In fact they may be seen as a stronger means of enforcement than either deed restrictions or collateral agreements, because the holder of a mortgage has a duly recorded interest in the mortgaged property of a sort that is familiar to all real estate and financial professionals. Again, however, this means of enforcement is not necessarily continuous from one owner to the next. When the property is resold the restrictions can be reestablished only if the enforcing agency is positioned to see that the purchaser assumes the existing mortgage or grants an identical one.

**Long-term lease restrictions.** Long-term ground leases that provide for lessee-ownership of homes on the leased land are the usual method by which CLTs establish restrictions on the use, resale and financing of resident-owned homes, at least in the case of free-standing single-family homes (condominiums often call for the use of deed covenants, as described in

Chapter 14, “CLTs and Condominiums”). Such ground leases can also be used by any other public or private entity wishing to restrict the transfer or use of housing. Some public housing authorities (e.g., in Boulder, Colorado) have used ground leases to restrict use and resale of subsidized resident-owned units. At least one municipality (Minneapolis) has used ground leases to assure the preservation of resale restrictions for subsidized limited-equity coops. And some Universities (e.g., Stanford University) have used ground leases to preserve the affordability of resident-owned homes for faculty members.

Separate ownership of land and buildings is usually seen as a defining characteristic of the CLT model. However, there are a few jurisdictions in which CLTs have found it to be legally or financially impractical to separate the ownership of land and buildings. In these jurisdictions, CLTs have used long-term leases that do not separate the ownership of the improvements from the ownership of the land, but that do separate the ownership of a long-term “leasehold estate” from the fee interest held by the CLT. With both types of lease, the enforceability of the restrictions that they contain is strengthened by the fact that ownership is shared – on an ongoing basis, from one resident to the next – according to an agreement signed by both resident-lessees and the CLT-lessor.

**Bylaw controls.** Bylaw controls can be used to establish restrictions with models of ownership, such as housing cooperatives, that place title in a corporation. The residents of housing coops own stock in the corporation and have long-term proprietary leases for the units in which they live. In the case of *limited equity* housing coops, the bylaws of the corporation limit the price that residents can receive for the sale of stock or the transfer of a lease, and are likely to impose other restrictions as well. Bylaw controls avoid most of the legal problems that accompany long-term deed restrictions and collateral agreements, but the assurance of legal enforceability is offset by the chance that the members of the corporation themselves may amend the bylaws to remove resale restrictions. These resident members are the very people who have much to gain by removing or reducing resale restrictions in a time of increasing real estate values. The threat that restriction may be removed can be addressed, however, when coops are developed on land leased from a CLT – in which case the CLT lease can require that the restrictions remain in place.

Limited Equity mobile home park (or “manufactured housing community”) coops are similar to conventional limited equity housing coops except that in this case the members lease lot sites from the coop corporation but typically own their own manufactured housing on those sites. Restrictions on the resale and use of the housing are established in the members’ lot leases, and such lease provisions may be required by the corporation’s bylaws, but, as with conventional limited equity coop members, these coop members may be motivated to amend their bylaws to allow removal of restrictions – unless, again, the land occupied by the park is leased from a CLT through a master lease that requires continued restrictions.

**Conservation easements.** Conservation or agricultural easements (sometimes known by other terms, including “agricultural restrictions” and “servitudes”) have become a common means of establishing restrictions on the ownership of agricultural property. The type of conservation easement widely used by conservation land trusts removes some or all development rights from a parcel of land and may establish other restrictions designed to preserve ecologically sound use. Such easements are frequently used to preserve farmland, as well as other forms of open space. When the goal is to preserve farmland or whole farms *as farms that farmers can afford to buy*, the easement may give the holder a preemptive

option to purchase the property for its appraised *agricultural value*, as is the case with farm preservation programs in Massachusetts and Vermont. The provisions of some such easements can be very similar to CLT lease provisions – with restrictions relating to price, buyer eligibility, owner-occupancy, and use.

### **Comparison of Deed Restrictions and Leases**

As noted above, the long-term ground lease continues to be the standard method by which CLTs establish and enforce restrictions on ownership. Or, as CLTs themselves have more commonly expressed the matter, the lease is the vehicle within which the interests of individual residents and the long-term interests of the community are sorted out, balanced and respectively protected. Nonetheless, as we have also noted, deed restrictions are often used by CLTs to establish restrictions on condominiums – including condominium where only a portion of the units are subject to affordability restrictions (an increasingly important part of the housing stock of CLTs in some markets). For this reason, and because deed restrictions are a common method of establishing restrictions on affordable homes that are created through inclusionary zoning programs and are then stewarded by CLTs, there has been a growing interest in deed restrictions within the CLT movement, and a certain amount of debate regarding the relative merits of deed restrictions and leases. We will summarize the main elements of that debate here.

**Deed restrictions.** When compared to CLT ground leases, deed restrictions tend to be seen as the “simpler and easier” means of establishing restrictions. This does not mean that the documents themselves will be simpler and easier to read than CLT leases. For a given set of restrictions, the two kinds of documents will be approximately the same length and will be written in very similar terms. Nonetheless, deed restrictions can be easier to use in certain situations, and they do have certain advantages over CLT leases as means of establishing and enforcing restrictions on ownership, including the following.

- They avoid the possible complications of separate tax assessments on the separate ownership interests.
- Deed-restricted properties do not require “leasehold mortgages,” so many mortgage lenders are more comfortable with them.
- They are more acceptable to those homebuyers who feel strongly about “owning the land as well as the house.”
- They can be used with condominium ownership on a unit-by-unit basis.
- Resale restrictions attached to deeds can be “self-enforcing” to a certain degree and for a certain period of time.

Most deed restrictions are designed to last for relatively short periods of time – usually not more than 30 years – and it can be argued that, if a program strives to preserve affordability only for these finite time spans, the deed restriction is a practical way of doing so. Again, however, there are both legal and practical concerns about the enforceability of deed restrictions over longer periods of time.

The legal status of long-term deed restrictions varies from state to state. Some states specifically limit deed restrictions to a certain period (e.g., 30 years), and in most states “perpetual” deed restrictions are considered invalid as a “restraint on alienation” or violation of the “rule against perpetuities” (see Chapter 9, “Enforceability of the CLT’s Preemptive Right,” regarding these common law principals). Generally, the longer the

duration of the restriction and the farther the party imposing the restriction is removed from the property, the less defensible is the restriction. A few states (currently Massachusetts, Vermont, Maine, Rhode Island, and Oregon) have enacted laws explicitly authorizing “perpetual” deed restrictions for the purpose of preserving the affordability of subsidized owner-occupied housing. Most states, however, have not.

Even if all the legal obstacles to enforcement of these affordable homeownership covenants are removed, the restrictions are often not effectively enforced. The supposed self-enforcement process may not work in practice – at least not for the full set of restrictions. It is worth looking at what is likely to happen with regard to the enforcement of each of the four types of restriction noted above when a deed-restricted property is to be sold in the absence of a fully developed monitoring program.

- *Price restrictions.* The assumption has been that, when a property is to be sold, a diligent title search – conducted for a potential mortgagee or title company – should bring the price restriction to light, and a potential buyer or mortgagee would not knowingly choose to violate them. If the difference between the allowable “purchase option price” and the then market price is great, however, the owner of the property may have a strong incentive to avoid price restrictions. A speculator, especially if prepared to pay cash, may be willing to pay more than the purchase option price if the actual price would still be enough below the property’s market value so that the risk of a legal challenge would be seen as worthwhile. Or the necessary title work may simply not be done carefully enough at the time of resale, with the result that the existence of a restriction attached to a deed decades earlier may *not* come to light. (For this reason, some CLTs record not only the covenant but a lien securing a loan for a nominal amount as a more familiar way of flagging the existence of the restrictions.)
- *Buyer eligibility restrictions.* Buyer eligibility restrictions relating to the incomes of potential buyers are probably more likely to be violated in practice than are price restrictions. The price for which a property is to be transferred is necessarily known by the parties to a transaction, whereas the buyer’s income is not necessarily known unless the transaction is monitored by an agency that will insist on reliable documentation of the buyer’s income.
- *Occupancy and use restrictions.* These restrictions, which must be applied on an ongoing basis, not just at the time of transfer, are obviously not self-enforcing. Without ongoing monitoring, there is little to prevent an owner from moving out of a restricted home and renting it for a substantial profit, and/or allowing its condition to deteriorate to the point where the public’s investment in the property is wasted.
- *Mortgage financing restrictions.* Practical enforcement of these restrictions requires that a monitoring agency be in position to review proposed mortgage terms and determine whether they are consistent with the restrictions.

Until quite recently, because they were assumed to be self-enforcing, deed restrictions generally were not monitored. Programs were simply not being funded or put in place to support monitoring. As the failure of self-enforcement has become more apparent, however, a growing number of programs *are* now being established to monitor and enforce deed restrictions established through state and municipal programs that subsidize affordable homeownership or that require its creation through “inclusionary” ordinances

(see John E. Davis, *Shared Equity Homeownership: The Changing Landscape of Resale-Restricted, Owner-Occupied Housing*, published by the National Housing Institute). In fact a growing number of CLTs are now charged with responsibility for monitoring deed-restricted homes.

Finally, it should be noted that a sponsoring agency that does not have a continuing relationship with the homeowner is not only less able to enforce restrictions; it is also not in position to provide support services for lower income, first-time homeowners. If a homeowner gets into financial trouble, such an agency will not be aware of it and will not provide assistance. If the financial trouble results in a mortgage foreclosure, a deed restriction that has been subordinated to the mortgage (as is usually the case) will be wiped out. Not only will the homeowner lose her home, but the public will lose the investment it has made in the affordability of the home.

**CLT leases.** Compared to deed-restricted homeownership, the CLT's seemingly more complicated approach to homeownership restrictions involves features that are less familiar to the majority of homebuyers and home mortgage lenders. However, the CLT lease does have some important advantages, both as a means of establishing and enforcing restrictions on ownership and as a basis for supporting lower income homebuyers. These advantages include the following.

- The fact that the lease represents an agreement between parties that both have continuing ownership interests in the property provides a strong legal basis for the long-term – in fact perpetual – enforcement of restrictions.
- Through its collection of a monthly lease fee, the CLT is positioned to monitor the homeowner's occupancy and use of the property. (A CLT may of course be similarly positioned to monitor covenant-based restrictions through the collection of a monthly "stewardship fee".)
- Through its collection of a monthly lease fee, the CLT is positioned to recognize financial (or other) problems experienced by a homeowner, and to assist in dealing with these problems. (Again, the collection of a monthly "stewardship fee" may help to create a similar relationship.)
- As ground lessor, the CLT is positioned to review proposed mortgage financing and prevent financing that would expose the homeowner to undue risk.
- In the event of foreclosure of a leasehold mortgage, the CLT may be able to re-acquire the foreclosed home, and in any case will retain the community's investment in the land.

Although theoretical questions have been raised as to whether the 99-year term of the CLT's preemptive option might be held to violate the rule against perpetuities (potentially exceeding the traditional common law measure of a "life in being plus 21 years"), to our knowledge the CLT preemptive purchase option has never been challenged in court and there are reasons to believe that such a challenge would not succeed (see Chapter 9, "Enforceability of the CLT's Preemptive Right").

The CLT lease also provides a strong legal basis for enforcing the CLT's occupancy and use restrictions. The exact procedural details and substantive requirements will differ from jurisdiction to jurisdiction. Generally, however, the lessee's rights of possession of the land depend upon compliance with the lease terms. Failure to comply with these

terms gives rise to the right of the landlord to terminate the lease and evict the lessee or seek other remedies, such as damages or injunctive relief, where appropriate.

On the *practical* level, the CLT lease provides an effective means of seeing that all four types of restriction are actually enforced.

- *Price restrictions.* When the homeowner eventually wants to sell, the possibility that the sale could be carried out in violation of the lease's price restrictions is extremely limited. Any but the most woefully ill-informed and ill-advised buyers would understand that they could not buy the land from the existing homeowner and would *have* to deal with the CLT land owner. The CLT will be a party to the transaction. Before approving the transfer of the lease or entering into a new lease with the buyer the CLT will make sure that the price is permitted under the restrictions.
- *Buyer eligibility restrictions.* Again, the CLT will be a party to the transaction. Before the transaction can be closed, the seller will need to be sure that documentation of the buyer's income qualifications has been submitted to the CLT for its approval.
- *Occupancy and use restrictions.* The likelihood that these restrictions will be enforced in practice is supported by the necessary ongoing interaction between the parties. In particular, the homeowner is responsible for making monthly lease fee payments to the CLT (unless these are paid to and escrowed by a mortgagee). If a CLT finds that these fees are not being paid, it will typically contact the homeowner and may then learn of other problems or violations; for instance, the homeowner may no longer occupy the home and may have rented it to others. (Again, a number of CLTs now do charge monthly "stewardship fees" to the owners of deed-restricted condominium units.)
- *Mortgage financing restrictions.* A typically diligent lender will recognize the fact that the lessee does not own the fee interest in the land. Before accepting the leasehold interest as collateral, the lender will review the lease document that creates that interest, and will learn that the mortgage must be explicitly permitted by the CLT land-owner. (In the few instances where a not-so-diligent lender has taken a mortgage without the knowledge and permission of the CLT and where foreclosure is then threatened, it has been possible for the CLT to prevent foreclosure by showing that its rights as lessor have been circumvented.) Before permitting a mortgage, a CLT normally seeks assurance that it will have the right and opportunity to cure such a default, that it will have a right to purchase a defaulted mortgage, and, in some cases, that it will have an opportunity to repurchase a foreclosed home – all of which reduce the likelihood that the public's investment in an affordable home will be lost.

In summary, the CLT's ability to ensure that all of these restrictions are enforced in practice is strongly supported by the closeness of the relationship between the CLT and the lessee as co-owners of the property. In this respect, the CLT ground lease has a fundamental advantage over *un-monitored* deed restrictions. In situations where deed restrictions *are* monitored – by a CLT or other agency – the difference between deed restriction and ground lease is of course reduced – with the degree to which it is reduced depending on the closeness of the relationship. If deed restrictions on a home are monitored by an organization to which the homeowner is obliged to pay a monthly fee (regardless of what the fee is called) and if the state is one in which there is a statutory

provision for perpetual affordability restrictions, then the difference in enforceability is likely to be slight. And the difference may be even further reduced if the homeowner is also related to the monitoring organization as a *member* of that organization.

Even when there is little difference in the enforceability of the two kinds of restrictions, however, the CLT lease still has one potentially important advantage over the deed restriction. A mortgage on a deed-restricted home applies to the entire property (land and improvements). If the mortgage is foreclosed – or a deed in lieu of foreclosure is given – the entire property, and the public’s investment in that property, will be lost (unless the mortgage has been subordinated to the restrictions, which is rare). A mortgage on a CLT home, however, normally applies only to the improvements and the leasehold interest in the land. If the leasehold mortgage is foreclosed, the CLT will retain ownership of the fee interest in the public’s property, the land. Whoever then acquires ownership of the improvements will become a lessee of the CLT. In such situations the Model Lease allows the removal of resale and occupancy restrictions, but, if this happens, the lease then allows the CLT to increase the lease fee to reflect the market value of the no-longer-restricted property, so the CLT will receive an ongoing revenue stream, which may be substantial in some markets, and which can be used to help support the CLT’s program until such time as the organization either reacquires the improvements on affordable terms or liquidates its equity in the land entirely.

Finally, It should be said that, in the eyes of some, the CLT ground lease is preferable to the deed covenant on philosophical grounds. The ground lease treats land and improvements as two fundamentally different forms of property – land as a limited resource in which all members of a community have a necessary interest, improvements as human creations in which particular individuals have a more exclusive interest. Deed covenants do not make this philosophical distinction. They may establish the same restrictions as CLT leases, but in the eyes of many CLT advocates, the restrictions are not philosophically grounded in the way that CLT lease restrictions are.

## Chapter 9

# Enforceability of the CLT's Preemptive Right

*Editor's note: This chapter was written by Deborah Bell, a professor in the University of Mississippi Law School. It was first published in 1991 by the Institute for Community Economics in the CLT Legal Manual, and is presented here without revision. In the view of the CLT Network, the chapter continues to provide a useful overview of the legal principles that affect the enforceability of the CLT's preemptive right to control the resale of CLT homes. Furthermore, as far as the CLT Network is aware, the enforceability of the CLT's preemptive right has not been denied by any court of law in the two decades since the chapter was first published.*

The preemptive right may well be the most crucial feature of the community land trust model. It is therefore important for organizers of CLTs to anticipate certain questions that may be asked about the legal validity of the preemptive right, and to be prepared to explain why the provision should be enforceable. This chapter discusses the importance of the provision, explains the source of questions about its legality, and outlines the reasons that it should be enforceable.

### The Importance of the Preemptive Right

The CLT's preemptive right is a right to purchase the home of a ground lessee for a price limited by a specified "resale formula" (see Chapter 12 regarding the design of specific formulas). The right of repurchase alone, even without the price limitation, is important because it permits the CLT to see that the new purchaser is one of the group the CLT was created to serve. Nonetheless, in some circumstances, the preemptive right would have little real effect without the price limitation. If a CLT is forced to repurchase a highly appreciated home at a market price, it will probably be unable to make the home affordable for another lower income person. In rapidly appreciating real estate markets, the CLT cannot achieve its goal of preserving affordability unless the preemptive right can be enforced at the limited price.

On a different level, the preemptive right to purchase at a limited price is important as an expression of the basic principle that underlies the CLT model: that land, as a finite resource, should not be used as a source of speculative gain; that increases in property value not attributable to an individual's effort should benefit the community as a whole and not the individual land owner. The preemptive right to purchase at a limited price is the implementation of this idea and the residents' expression of commitment to the concept.

### The Questions of Enforceability

Clearly, a model of ownership that limits resale prices so as to divide value between individuals and the community departs rather drastically from customary American patterns of land ownership. Organizers of land trusts may face questions from a variety of people about whether the preemptive right to purchase at a limited price can be legally enforced. Their questions are likely to focus on two aspects of the right: first, the fact that the limited price may be below market rate, and second, that the right does not expire

after a certain length of time but potentially goes on (from one lease term to another) forever.

The basis for the concern about the below-market price is that American law tends toward the view that the current owner of land should be able to do with it whatever she wishes, including selling it at any price, and that the one who transferred the property to her (here the CLT) may not put limits on her full ownership by limiting her rights of disposal. In legal jargon, this rule is called the “rule prohibiting unreasonable restraints on alienation.”

The concern about the length of the preemptive right stems from the view of American property law that one generation of landowners (the CLT) should not be able to create an interest in land (the preemptive right) that can be exercised at a distant time in the future. This view is embodied in the “rule against perpetuities.” Lay readers should not be intimidated by the legal language; the essence of the two rules is explained below, and many lawyers do not themselves understand the more technical aspects of the rules.

There are very sound and logical responses to these questions, the most significant of which is that the American property rules do not necessarily accomplish their stated purposes while the CLT actually does accomplish those purposes. More technical legal responses are also discussed in this chapter. In addition, certain cautionary measures are proposed for inclusion in CLT documents to reassure those with concerns about the validity of the preemptive right. An understanding of these materials is a valuable tool in planning and organizing a CLT, as well as an important part of the education process regarding land ownership and needed changes in the American land tenure system.

### **The Limited Price Preemptive Right and Restraints on Alienation**

One of the most basic tenets of Anglo-American property law is the “free transferability” of land. By the 1800s, English and American judges had developed a series of rules designed to ensure that the current owners of property could dispose of it as they chose, with few restraints imposed by the previous owner. The assumption was that it was socially and economically desirable for landowners to acquire absolute control over their property, and restraints imposed by previous owners were thought to be repugnant to the very nature of ownership. The specific policy reasons for this focus on full ownership were: (1) to prevent the concentration of wealth caused by transfer restrictions that the landed aristocracy placed on their property; (2) to encourage commerce by making land more freely transferable; and (3) to provide incentive for owners to improve and develop land by guaranteeing that they could recover their investment through unrestricted sale.

The policy favoring consolidated ownership in one person is today expressed in the rule prohibiting unreasonable restraints on alienation. Even indirect transfer restrictions, such as the CLT preemptive right, must be examined under the rule to determine the restriction's validity. Most courts look at the following factors, set out in the Comments to the Restatement of Property, to determine whether a particular restraint is reasonable: whether the restraint (1) protects a property interest of the one imposing the restraint; (2) accomplishes a worthwhile purpose; (3) is limited in time; (4) prohibits a transfer that the owner would be unlikely to make anyway; (5) only excludes a small number of potential transferees. The Restatement approach balances between interests of the previous owner and society in enforcing the restraint (factors 1 and 2) and the extent of the burden placed on transfer by the current owner (factors 3, 4, and 5). A restraint is invalid if it serves no

reasonable purposes or if the burden on transfer is so great that it outweighs the value of the restriction. In making this determination, it is important to consider the policy goals of wealth dispersal, economic development, and property improvement that underlie the rule.<sup>1</sup>

Application of the first two factors clearly shows that the CLT preemptive right serves a reasonable purpose. Without question, the right protects the CLT's interests; it is crucial to the actual operation of the land trust. The right also serves the repeatedly emphasized public goal of providing much needed affordable housing. On the other hand, it may be argued that the right does burden or inhibit transfer to some extent. The preemptive right certainly limits the number of initial transferees (factor 5) by requiring transfer first to the CLT or income-qualified persons; however, this fact alone is not likely to invalidate the right. A resident would not be discouraged from improving or selling simply because she was required to offer the house first to the CLT or income-qualified persons. In fact, depending on the specific resale formula involved, she may be more likely to improve or sell the property, having assurance of at least one potential buyer.<sup>2</sup>

It is the limited price aspect of the right that, at first glance, reduces the owner's incentive to transfer (factor 4). If she is limited to simply recovering her investment, rather than fully profiting from an increase in market value, the owner may hold the property rather than selling if she has no personal reason to move. She will not be motivated to sell by an increase in her property's market value that she cannot claim for herself. Thus, the argument would go, the price limitation does hinder free transferability of the property.

At this point in the analysis, it is instructive to recall exactly why free transferability is important. One of the reasons for encouraging transferability is to prevent concentration of wealth. The limited price preemptive right may actually accomplish this goal better than the rule against unreasonable restraints itself.<sup>3</sup> If property can always be bought by the highest bidder, a substantial number of people are completely excluded from ownership of property. By keeping the property available at a reasonable price, the CLT model disperses ownership and prevents concentration of property in the hands of the wealthy.

Another stated reason for the rule is that restraints on transfer may discourage improvement of property.<sup>4</sup> The limited price preemption should not discourage improvement because CLT resale formulas generally allow homeowners to recover the cost or value of improvements as part of the resale price, though specific formulas vary in the extent that they do so (see Chapter 12).<sup>5</sup> Furthermore, the CLT model should encourage improvement and prevent deterioration by putting residential property in the hands of owner-residents who have more incentive to fix up property than do absentee landlords. The promise of long-term security of tenure for residents may well be the best method for encouraging improvement of residential property.

The only remaining objection to the limited price preemption is that it will impede commerce because a resident will not have the special motivation to sell that is provided by increases in the market value of the home. There are two responses to this objection. First, the goal of encouraging commerce and economic development focuses on general commerce and not commerce with respect to one piece of property. While the price limitation may prevent a resident from selling a particular piece of property to the highest

bidder, it may improve commerce in general by decreasing housing costs and freeing up dollars for use in other markets. In addition, several courts have noted that where a limited price preemption was an essential part of the original transaction, it has encouraged commerce, because the original transfer might not have otherwise occurred.<sup>6</sup> This reasoning is certainly applicable to CLT transfers. The second response to the objection regarding commerce is that promotion of commerce is merely one of several societal goals, and must be balanced with other goals, including the need to provide adequate and affordable housing.

A review of the cases shows that limited price preemptive rights are generally upheld when they serve a legitimate purpose or promote significant public policies, and when the person giving the option received some benefit in return. Limited price rights that have been held unenforceable are those in which the person demanding the option had no legitimate interest in the property or where the only purpose was to restrain alienability.<sup>7</sup>

In summary, the preemptive right promotes significant interests of the CLT and society, while at the same time actually accomplishing the original purposes of the rule prohibiting unreasonable restraints – dispersing wealth, encouraging improvements, and promoting commerce by increasing the disposable income of its residents. To the extent that it places some limit on transfer of a specific piece of land, the burden is outweighed by the accomplishment of the goals of the CLT and societal housing goals.

### **The Indefinite Preemption and the Rule Against Perpetuities**

CLT organizers may also face questions regarding the duration of the preemptive right. The land trust resident is permitted to transfer the home and lease from generation to generation, and the preemptive right applies to decisions by later generations of residents to sell the property. Thus, the preemptive right is designed to continue in effect as long as the ground lease continues in effect.

As a part of the emphasis on “full” ownership by the current owner, English and American judges viewed with disfavor certain interests in land that would not take effect until long in the future. Future interests were believed to hinder free marketability, keeping property out of commerce. In addition, it was thought undesirable to let a past generation curtail the use and transfer of property in a present generation's hands (referred to as “Dead Hand Control”).<sup>8</sup> These policies found expression in the “rule against perpetuities,” which is one of the most confusing and frequently criticized of modern property rules. Unlike the more general rule prohibiting unreasonable restraints, the rule against perpetuities accomplishes its goal of free transferability only to a limited extent, by focusing on a very narrow range of future interests called “contingent” interests. Specifically, the rule requires that “contingent” interests must become “vested” within twenty-one years of a “life in being” or the interest is invalid.

Explaining the meaning of “contingent,” “vested,” and “life in being” is far beyond the scope of this chapter; it is sufficient to know that, under the traditional approach to the rule, a preemptive right to purchase is “contingent;” it was considered to “vest” when the current owner decided to sell, thereby triggering the operation of the right.<sup>9</sup>

Applying the old approach to the CLT model, the preemptive right violates the rule against perpetuities because it could become operative for the first time more than twenty-one years after the death of the original resident. It is quite conceivable that a home on CLT land could be passed from the first resident to her children, then to her

grandchildren, and that a grandchild would decide to sell the property more than twenty-one years after the original owner's death.

Recently, however, courts have begun to move away from holding that a preemptive right that extends beyond the perpetuities period is automatically void. Instead, they view the option as a possible restraint on alienation subject to the test of reasonableness discussed above.<sup>10</sup> The duration of the option then becomes simply one of the factors to be weighed in determining whether the benefits of the option outweigh its burden on commerce. These courts have frequently upheld perpetual options, stating that the rule against perpetuities was created with policy considerations in mind, and should be applied with those policies in mind. Thus, a preemptive right that does not hinder transferability or discourage improvement does not violate the rule.

Although no court has considered the validity of a CLT preemptive option, a review of recent cases illustrates the likelihood that it would be upheld. In every case involving cooperatives or condominiums, the litigated ownership models most closely resembling the CLT, courts have refused to set aside perpetual preemptive rights under the rule against perpetuities. They have emphasized that the rule against perpetuities developed at a time when condominium ownership was unknown, and have stated that the rule should not be mechanically applied but evaluated in light of the policies behind the rule:<sup>11</sup> "The law of property ... is not a mathematical science but takes shape at the direction of social and economic forces in an ever changing society, and decisions should be made to turn on those considerations."<sup>12</sup> In balancing the usefulness of preemptive rights against the possible harm of their use, courts have stressed the important public policy of providing affordable housing,<sup>13</sup> have noted that the preemptive right is a useful tool for establishing a protected residential community free from non-residential uses,<sup>14</sup> and have found that the ordinary preemptive right places little burden on transferability. In fact, even courts that have struck down preemptive rights in other contexts have recognized that condominiums involve unusual interests that need not be subjected to the rule against perpetuities.<sup>15</sup>

There is no reason why the same result should not be reached in an analysis of the CLT preemptive right under the rule prohibiting unreasonable restraints. As discussed above, the value of the CLT limited price right outweighs its burden on transferability. The only additional question to be addressed is whether the perpetual nature of the limited price right increases the burden to the extent that the benefit is outweighed. Again the only possible effect is the long-term availability of CLT property to the highest bidder. While this may perpetually limit commerce with respect to a particular piece of property, it may also permanently improve local commerce by increasing the buying power of a number of persons in the area who would otherwise be spending all their spare income on housing. In contrast to the negative effect on commerce of real estate speculation, the CLT right will have the positive effect of providing permanently affordable housing.

In summary, the preemptive right should not be held to violate the rule against perpetuities because (1) the modern approach is to analyze the right under the Restatement rule against unreasonable restraints, and (2) a balancing of the factors listed in the Restatement shows that the benefit to the CLT and society as a whole outweighs any burden imposed on transfer.

## Other Arguments

**Freedom of Contract.** Questions about both the durational and limited price aspects of the CLT preemptive right may also be answered by focusing on the voluntary nature of the arrangement. A number of courts have upheld options simply because it was clear that the party granting the option intended to create it, understood the agreement, and received something in return.<sup>16</sup> The fact that the land has since increased dramatically in value is not alone sufficient to make the option unfair.<sup>17</sup> This reasoning is equally applicable to the agreement between the resident and CLT. In exchange for the preemptive option, the resident has obtained assistance in purchasing housing, providing her with homeownership that might otherwise have been impossible.

**Rule Not Applicable to Preemptive Rights.** In some states it is not even necessary to reach the arguments above. The following approaches have been taken in various states, with the result that the preemptive right does not violate the rule against perpetuities.

- Some courts hold that the right is vested at the time it is created. In that case the rule against perpetuities is not violated because the rule simply requires interests to vest within the necessary period.<sup>18</sup>
- Some courts hold that the preemptive right is a contract right rather than a property right and does not come under the rule at all.<sup>19</sup>
- In a few states, legislatures have passed statutes that specifically authorize preemptive rights such as the CLT right.

Local counsel should be advised of these possibilities and requested to check the particular state's laws.

**Violation of the Rule Does Not Completely Invalidate Interest.** In a growing number of states, the approach to rule against perpetuities questions is to apply what is called the "wait and see" test.<sup>20</sup> Under this test, an interest is not completely invalidated because it might exceed the perpetuities period. Instead the court waits to see if the interest is actually exercised within twenty-one years of the appropriate measuring life. If it is, the interest is valid. Thus, even if a state follows the old rule of perpetuities with respect to preemptive rights, the CLT would be in no worse position than if it had originally designed an option to fit within the perpetuities period.

Other courts reach a similar result by finding that the parties intended that the interest not exceed the perpetuities period, and then imposing some reasonable time limit. Both of these methods indicate that courts are very reluctant to simply strike down any preemptive right that has a valid purpose and that the parties intended to create, even if it is designed to last forever. For these reasons, it is likely that an option such as the CLT right, which clearly serves overriding public interests, would be upheld.

## Protective Provisions

There are several measures that CLT organizers should take to ensure that the arguments set out above are effective, or that, if for some reason they are held invalid, their inclusion has not been damaging.

1. The purpose of the repurchase right and the public interests that it promotes should be emphasized in the lease. (See Model Ground Lease, Introductory ("Whereas") Section, and Section 10.1.)

2. The lease should very clearly document that the resident (a) understands and supports the purposes of the CLT; (b) has voluntarily entered into CLT ownership, realizing that the price limitation is a fair exchange for the CLT's provision of affordable housing; and (c) entered into the lease only after receiving a full explanation of the lease, including the resale agreement, and upon the independent and informed advice of counsel. Such a provision makes clear not only that the resident entered the contract freely, with a full understanding of its meaning, but also illustrates that the provision is substantively fair. (See Model Ground Lease, Article 1: Letters of Agreement and Attorney's Acknowledgement.)
3. The lease should make clear that the resident may recover her investment upon resale, including the value of improvements (to the extent that the particular resale formula allocates the value of improvements to the resident). A limited price preemptive right that does not account for the value of improvements would be more likely to be held violative of the rule prohibiting unreasonable restraints.
4. For protection in the unlikely event that the limited price aspect of the repurchase right is held unenforceable, the agreement should include a provision that the CLT will have a right of first refusal at the highest good faith offer received by the lessee if the repurchase option becomes unenforceable for any reason. (See Model Ground Lease, Section 14.5.)
5. The lease should provide that the CLT must exercise the preemptive right within a certain period of time or the right expires. Under the Restatement criteria for the reasonableness of a restraint, the durational factor may apply to the length of time for exercising the option after the owner decides to sell, as well as the actual length of time that the right exists. The Model Ground Lease affords the CLT forty-five days to elect to exercise its option (Model Lease, Article 10), a period shorter than some which courts have found reasonable under the Restatement.
6. The lease should provide that, in the event the preemptive right is held to violate the rule against perpetuities, the right will be limited to a time period not to exceed 21 years following the death of the last survivor of a specified group of "measuring lives." (See Revised Model Lease, Section 14.4.). It is of course possible to impose this time limitation from the outset and avoid any potential problems with the rule against perpetuities; however, because the perpetual aspect of the right is such a crucial aspect of the CLT, it is preferable to take the position that the rule does not apply to the CLT preemptive right for the policy reasons discussed in this chapter.

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<sup>1</sup> Comment to Restatement of Property 406.

<sup>2</sup> Courts have routinely held that a preemptive right in itself does not constitute an impermissible restraint. See Simes & Smith, *The Law of Future Interests*, Gray, *The Rule Against Perpetuities* 330 n.2, 61 Am. Jur. 2d 920. Comment to Restatement of Property 406.

<sup>3</sup> See *Gale v. York Center Community Cooperative, Inc.*, 171 N.E.2d 30 (Ill. 1961).

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<sup>4</sup> Some courts that have invalidated limited price options state that they have done so because the owner could not recover for improvements to the property. See e.g., *Iglehart v. Phillips*, 383 So.2d 610 (Fla. 1980).

<sup>5</sup> See *Gale*, *supra*.

<sup>6</sup> See *Emerson v. King*, A.2d 51 (N.H. 1978).

<sup>7</sup> See *Assoc. of Owners of Kukui Place v. Honolulu*, 742 P.2d 974 (Haw. 1987) (if policies promoted by the option outweigh those promoted by the rule, the option is enforceable).

<sup>8</sup> *Girard v. Myers*, 394 P.2d 678 (Wash. App. 1985) (no social importance).

<sup>9</sup> See *Alexander, The Dead Hand and the Law of Trust in the Nineteenth Century*, . L. Rev. 1189 (1985).

<sup>10</sup> See *Dukeminier, A Modern Guide to Perpetuities*, 74 Cal. L. Rev. 1867 (1986).

<sup>11</sup> *Shiver v. Benton*, 304 5.E.2d 257 (Ga. 1983); *Metro. Transp. Auth. v. Brukan Realty Corp.*, 479 N.Y.S.2d 646 (Supp. 1984); *Southeastern Pa. Transp. Auth. v. Philadelphia Transp. Co.*, 233 A.2d 15 (Pa. 1967); *Forderhouse v. Cherokee Water Co.*, 623 5.W.2d 435 (Tex. App. 1981).

<sup>12</sup> See *Cambridge Co. v. East Slope Investment Corp.*, 700 P.2d 537 (Colo. 1985); *Gale v. York Center Community Cooperative, Inc.*, 171 N.E.2d 30 (Ill. 1961); *Anderson v. So. East 72nd Street Condominiums*, 492 N.Y.S.2d 989 (Supp. 1985); see also *Association of Owners of Kukui Place v. Honolulu*, 742 P.2d 974 (Haw. App. 1987); *Chianese v. Culley*, 397 F. Supp 1344 (S.D. Fla. 1975).

<sup>13</sup> *Gale*, *supra*, 171 N.E.2d at 33.

<sup>14</sup> *Association of Owners*, *supra*.

<sup>15</sup> *Smith v. Mitchell*, 269 5.E.2d 608 (N.C. 1980).

<sup>16</sup> *Fenero Const. Co. v. Dennis Rante Corp.*, 498 A.2d 689 (Md. App. 1985).

<sup>17</sup> *Emerson v. King*, 394 A.2d 51 (N.H. 1978); *Edgar v. Hunt*, 706 P.2d 120 (Mont. 1985); *Izzo v. Brooks*, 435 N.Y.S.2d 485 (1980); *Smith v. Mithcell*, 269 5.E.2d 608 (N.C. 1980); *Lawsen v. Redmon Corp.*, 679 P.2d 972 (Wash. App. 1984).

<sup>18</sup> *Emerson*, *supra*; *Camalo v. Howard Johnson Co.*, 545 F. Supp. 395 (U.D. Pa. 1985).

<sup>19</sup> *Izzo v. Broades*, 435 N.Y.S.2d (1980).

<sup>20</sup> *Edgar v. Hunt*, 706 P.2d 120 (Mont. 1985); *Southeastern Pa. Transp. Auth. v. Philadelphia Transp. Co.* 233 A.2d 15 (Pa. 1967); *Robroy Land Co., Inc. v. Prather*, 622 P.2d 367 (Wash. 1980); *Stenke v. Masland Dev. Co.*, 394 N.W.2d 418 (Mich. App. 1986).

## **Chapter 10**

# **Legal Issues re. CLT Ownership**

The CLT lease creates a distinctive legal framework within which the ownership interests of the CLT and the CLT homeowner are defined and the rights of the two parties are sorted out with regard to a particular piece of property. The structure involves a “fee interest” in the leased land held by the CLT, and a “leasehold interest” (or “leasehold estate”) held by the homeowner. In most cases the homeowner’s leasehold interest is accompanied by or includes deeded ownership of the house and other improvements on the leased land. This chapter addresses some legal and practical questions that may arise regarding the CLT ownership structure and that are likely to be of concern to CLTs and their attorneys. Also, regarding the nature of the restrictions normally imposed on the ownership rights of the CLT homeowner, see Chapter 8, “Implementing Restrictions on Ownership.” Regarding the enforceability of these restrictions, see Chapter 9, “Enforceability of the CLT’s Preemptive Right.”

### **Legality of Separation of Interests in Land and Buildings**

With few exceptions, CLT leases provide for separate ownership of land and improvements. In a few jurisdictions, CLTs have been advised against using leases that provide for deeded ownership of the improvements by the ground lessee (see discussion below under “Leases that Do Not Separate Title to Improvements”). When it is possible, however, the preferred approach is for the ground lessee to have fee ownership of the improvements, which is usually conveyed with a deed. This approach is rooted in the philosophy that gave rise to the CLT model – a philosophy that views land as a finite resource in which all members of a community have a necessary interest, while viewing improvements as human products in which the particular individuals who produced or subsequently purchased them have a particular interest. And, for most CLT homebuyers, having a deed to a building conveys a stronger sense of ownership than is conveyed by having a leasehold interest in a building – even when the rights and monetary value conveyed by the two are more or less the same.

Though leases and deeds represent generally familiar concepts, the CLT’s separation of title to land and buildings is not a familiar practice for many people. Some may even argue that it is “legally impossible,” in spite of the fact that the practice is not unique to the CLT model and is relatively common in many other situations. As a general rule, there is no legal prohibition against the creation of separate ownership interests in a building and the underlying land. In fact, the horizontal division of what was once a single unit of real estate is no more difficult and causes no more confusion than the more common vertical division of a cornfield into the separate lots of a subdivision. In both situations, the owner of an estate in real property is simply selling a portion of her interest in that real property. She may divide her property along a horizontal, vertical, or inclined plane or in any manner according to her desire.<sup>1</sup>

More specifically, it is clear that ownership interests in improvements can be transferred independently of the land on which they are located. Even parts of buildings, as in the case of a condominium, may be considered to be independent units of real estate and as such may be alienable. It is well established that ownership interests in improvements as between buyers and sellers of realty are determined by reference to the intentions of the parties, as might be

expressed in or inferred from a written agreement such as a purchase agreement or deed.<sup>2</sup>

Separation of ownership of land and buildings as between lessor and lessee is also a long-standing practice that modern-day courts have little trouble in upholding. In two tax cases where ownership of buildings separate from the underlying realty was disputed, the New York Court of Appeals has said: "...no doubt there is power by agreement to separate title,"<sup>3</sup> and "...nor is there any reason in law or policy why there may not be a separate ownership of buildings apart from lands on which they rest .... nor is there any ground in the natural order which makes unworkable such a concept of separate ownership."<sup>4</sup>

In fact such separate ownership is quite common. Long-term commercial ground leases, for instance, are usually transactions in which the landlord leases unimproved real property which the tenant develops. Such leases frequently provide for the demolition of existing structures on the land and the erection of new ones, with title to the new buildings vesting in either the landlord or the tenant as provided by their agreement.<sup>5</sup> Mobile homes located on leased mobile home park lots, where not considered to be personalty, provide another common example of separate ownership. Also, in many jurisdictions, condominiums may be built and owned on leased land.

### **Removal of Improvements from Leased Land**

When the ownership of land and improvements is separated between ground lessor and ground lessee, the question of the lessee's right to remove the improvements from the leased premises is an important consideration for both parties. Community land trusts generally have a strong interest in seeing that improvements are not removed. A CLT that has developed affordable housing or otherwise improved land for the long-term benefit of the local community has a clear interest in seeing that the improvements are not removed from the CLT's land and that the benefits provided by the improvements on that land are not lost to the community. To protect this interest, a CLT can, as a condition of the ground lease, prohibit the removal of improvements. The Model CLT Ground Lease contains such a prohibition (Section 7.1). Nonetheless, there may be situations in which a CLT has reason to allow the removal of at least certain improvements, and some CLTs have in fact entered into lease arrangements that allow removal. It is therefore relevant to review some of the consequences of a lessee's right of removal when such a right is allowed under a ground lease.

One of the consequences of separation of ownership of land and improvements is that the two ownership interests can interfere with each other at the end of the lease term, making the timing of any removal an important consideration in the drafting of the lease agreement. Where the right of removal is provided but with no agreement as to time of removal, a number of states have adhered to the original common law rule that improvements must be removed before the expiration of the term or be forfeited.<sup>6</sup> However, most states have evolved some exceptions in the face of the potential harshness of the rule. For example, if the length of the term is uncertain or if the lease is terminated prematurely (say, as the result of a default by the lessee), then a majority of the courts have allowed the lessee a "reasonable time" after termination to remove her improvements. Reasonable time is held to vary with the facts and circumstances of the case.<sup>7</sup>

It should be noted that the Model Lease not only prohibits removal of the improvements but provides that title to the improvements shall revert to the CLT upon the termination of the lease (Section 7.7). In the event of such reversion, however, the Model provides for compensation to the lessee in the amount of the purchase option price as determined by the

formula set forth in the lease. Given this provision for compensation and given the difficulty and expense of moving and re-establishing a major structure on a new site, it is unlikely that a CLT lessee would want, or be able, to remove such a structure even if her lease permitted removal. Greater economic advantage would normally lie in selling rather than removing the structure.

Questions regarding removal are more likely to come up in connection with smaller improvements that are more readily movable and that may be moved independently of any major structures on the premises. If a CLT wishes to allow the removal of any such items, it should be careful to specify in the lease exactly what may be removed, under what conditions, during what period of time. In drafting these terms the CLT will of course be concerned with the effect of the removal of the improvement on the value and usefulness of the premises and remaining improvements.

### **Definition of Improvements**

When titles to land and improvements are separated, it is obviously important that the exact nature of each party's ownership interest and the exact division of interests intended by the CLT be carefully defined. Two types of distinctions are important for the CLT in this regard.

First, it is important to distinguish between those things that are included as parts of the house and other permanent improvements owned by the lessee (collectively termed the "Home" in the Model Lease) and those things that remain a part of the premises owned by the CLT (the "Leased Land" in the Model Lease). Is the basement of a building included in the improvements? Are the pipes leading from the building to the street a part of the improvements or of the premises? Answers to questions such as these may affect various issues relating to liability and responsibility for repairs – though the Model Lease assigns to the homeowner (lessee) *all* liability and responsibility for repairs relating to *both* the Home (the improvements) and the Leased Land.

A second distinction must be made between those things owned by the lessee as improvements to the realty and other items owned by the lessee as personalty (personal property, as opposed to real estate). As noted above, a CLT ground lease normally prohibits or restricts the removal of improvements. It does not restrict the removal of personalty. Nor does the CLT have a preemptive option to purchase items owned by the lessee as personalty. Obviously it is important to distinguish clearly between the two types of lessee property. (This distinction can be blurred, however, in jurisdictions where the practice is to give the ground lessee a bill of sale, rather than a deed, for the improvements. Since a bill of sale is normally used to document the sale of personalty, and since personalty is normally assumed to be removable, it becomes especially important to define the improvements as specifically as possible and to explicitly prohibit their removal.)

CLTs may also be concerned with yet another distinction, involving a different, though closely related, definition of the term "improvement." This is the distinction between "improvements" to an existing structure (which add value to the structure) and "repairs" (which renew or restore pre-existing value) – a distinction that has a bearing on some tax questions and that figures in some CLT resale formulas. An item classified as a repair in this sense (say, new siding replacing damaged siding) may still be classified as an improvement (or a part of an improvement) in the sense discussed above (it is neither removable personalty nor a part of the underlying land). The distinction between improvements and repairs is

discussed in Chapter 12 in connection with “resale formula design.” The discussion below is limited to the definition of improvements as distinct from the leased premises on the one hand and from the lessee's personalty on the other hand.

If the general term “improvements” (or the term “Home” as in the Model Lease) is used in a lease agreement instead of an itemization of particular improvements, then in certain circumstances a court may have to decide whether certain items are in fact improvements. A body of law has evolved defining what items are or are not improvements, but courts will first look to the context and contents of the lease in making their determination. If there is any question about whether certain items are or are not improvements, then the drafters of the lease should itemize.

The courts reveal virtually no disagreement as to whether buildings on permanent foundations should be classified as improvements. However, there are many other items that are less easily classified. Generally, the term “improvement” is not considered to include everything placed on land that is leased. Only those items of a permanent nature (excluding business trade fixtures) that are somehow annexed to the realty with an intention to make them part of the premises will be found to be improvements where the lease does not indicate otherwise. The ease or difficulty of removal of a disputed improvement is not necessarily the decisive test.<sup>8</sup>

Items within buildings that have been held to comprise improvements include (to name a range of examples) structural alterations, stages, doors, locks, awnings, and (more generally) anything that renders the premises more available, profitable, or useful but that is not akin to personalty.<sup>9</sup> Heating and air conditioning systems and their components have been held to constitute improvements. However, where these or similar items are not substantially attached to the premises (e.g., a window air conditioner) or where they are considered to be trade fixtures, they have not been classified as improvements.<sup>10</sup>

Outside of buildings, drains and ditches are counted as improvements if they comprise lasting systems for carrying off surface water or for irrigating land. The preparation of land for agriculture and the preparation of land for building sites are generally considered to be improvements to the land, as are fences and sidewalks or driveways. Orchards have been held to be improvements,<sup>11</sup> but most agricultural plantings of annual species would be viewed as impermanent personalty. The general rule is that improvements do not include those changes made merely for the temporary enjoyment of the present tenant. Accordingly, short-term fertilization of land is normally not considered to be an improvement,<sup>12</sup> but lasting improvements of the soil may qualify.<sup>13</sup>

Again, whenever questions can be raised as to whether certain items should be classified as improvements, the CLT ground lease should itemize and/or define improvements so as to answer the possible questions clearly. The particular items in question will vary depending on local circumstances and the goals of the particular CLT.

### **Leases that Do Not Separate Title to Improvements**

In a few jurisdictions, attorneys have found reason to question the practicality, if not the legality, of separating title to improvements on land leased from a CLT. The obstacles in these cases have not been a matter of outright prohibition of separation. Rather, people who regularly deal with real estate transactions in these jurisdictions have found that applicable law and practice either do not clearly support the separation of title or may give rise to practical problems when it comes to recording title to, mortgaging, or taxing property where

land and buildings are separately owned.

In a few instances, attorneys in such jurisdictions have advised CLTs to use a lease that does not recognize separate, deeded ownership of the improvements, but does provide for the purchase of a long-term leasehold interest in the entire property (both land and improvements). The price paid for such a leasehold interest (or “leasehold estate”) need not differ from the price that a CLT homebuyer would otherwise pay for a fee interest in the improvements and a leasehold interest in the land. Nor do restrictions on the resale of such a leasehold interest need to differ from other CLT resale restrictions (though the language in which appraisal-based resale formulas are described may need to be modified). In fact, almost all of the rights, restrictions and obligations that the more common type of CLT lease establishes for lessee and lessor can also be established by a lease that does not provide for separate ownership of the improvements. CLTs taking this approach have had little trouble adapting the Model Lease to their circumstances.

It should also be noted that the mortgageable value of a leasehold estate is not affected, one way or the other, by separate ownership of the improvements – as evidenced by the following statement in FHA handbook 4150.1 (Chapter 6, Section 5, Leaseholds):

“The Leasehold Estate may consist of both the improvement and the land, although in most cases the improvement is purchased in fee simple, subject to ground rent.”

The methods by which leasehold estates are to be appraised, as prescribed by Fannie Mae and Rural Housing Services, as well as FHA, among others, do not treat the value of improvements separately from the value of the overall leasehold estate (see Chapter 20, “Financing CLT Homes.”)

## Property Taxation

Important questions relating to property taxes include (a) the question of whether separately owned land and improvements can be assessed and taxed separately, and (b) the question of whether the lessee (whether owning the improvements or not) can be required to pay the taxes on the CLT’s fee interest in the property. The answer to the first question is that separately owned land and improvements can be and are assessed and taxed separately in most states. The answer to the second question is that CLT lessees are, as a practical matter, obligated to pay the taxes on both their own and the CLT’s property – but not always in the same way. The current version of the Model Lease specifically assigns direct liability for taxes and assessments on *both* land and improvements to the lessee (Section 6.1). The earliest version of the Model Lease did not assign liability for taxes on the land to the lessee but, instead, added the cost of these taxes to the lease fee. (See Chapter 13, “Establishing and Collecting Fees,” for a discussion of the pros and cons of the two approaches.) Tenants have not traditionally been liable for property taxes due on leased land, so it is important that the CLT lease explicitly assign the obligation to pay this tax – directly or as a component of the lease fee – to the lessee. Tenants *are* customarily liable for taxes due on improvements that they make to, or own on, leased land; Nonetheless, the ground lease should explicitly assign responsibility for taxes on improvements as well as land to the lessee, as the Model Lease does.

Special assessments to cover the cost of public improvements such as streets and sidewalks have been held not to be included in the term “taxes,” so the lease should specify that the lessee is responsible for paying assessments as well as taxes. The Model Lease does so specify (Section 6.1).

Local practice varies greatly on what assessors are willing to do as a matter of administrative practice. In some tax jurisdictions it may be difficult, if not impossible, to get separate tax bills for land and improvements (or for leased fee and leasehold estate). The lack of separate bills need not be a problem, however, as long as responsibility for paying all taxes is assigned to the lessee. (The more important question of whether local assessors will recognize the effect of the lease on the assessed value of the property is discussed in Chapter 17, “Property Tax Assessments.”)

The interplay between assessment and due dates for taxes and lease term can be dealt with in the lease. Payment of taxes on a pro rata basis for the time covered by a lease is the usual resolution, and is the judicial rule in some jurisdictions.

If taxes are not paid by the responsible party, then the other party may wish to pay the tax to protect its interest in the property and hold the defaulting party indebted to it. The CLT may treat delinquent taxes owed by the lessee as delinquent rent and add them to the lease payments.<sup>14</sup> Such a provision is contained in Section 6.4 of the Model Ground Lease.

### **Owner Liability**

In the typical CLT arrangement (regardless of whether improvements are deeded to the lessee or not), the lessee-homeowner is subject to the same liabilities as any other homeowner. For purposes of determining liability, property law has traditionally regarded a long-term lease as it would a sale of the premises for the term of the lease.<sup>15</sup> It is true that modern landlord-tenant law has made the landlord in a typical residential situation much more responsible for the condition of the premises and, in some situations and jurisdictions, has prohibited the landlord from shifting some risks to the tenant. Nevertheless, the 99-year lease arrangement that is typical of the CLT model should be viewed more in terms of traditional property law than in terms of modern, residential, consumer-oriented landlord-tenant law. Therefore, generally, the CLT as lessor probably should not be under any obligation to anyone for conditions that develop on the premises after the tenant is in possession.<sup>16</sup>

However, the CLT would be obligated to disclose to the resident any concealed dangerous conditions in existence when possession is transferred of which it has knowledge.<sup>17</sup> Also, the CLT may not be able to shift to the resident its liability to the public and adjoining landowners for certain dangerous defects, hazardous waste, and possibly other conditions that are the subject of specific statutes in a particular jurisdiction.<sup>18</sup>

The Model Lease assigns “sole responsibility and liability” to the lessee/homeowner (Section 9.1) and requires the lessee to carry liability insurance and name the CLT as additional insured (Section 9.4). Given this fact and the approach to liability taken by traditional property law as described above, it is highly unlikely that a situation would arise in which the CLT could be held liable in a way not covered by the lessee’s insurance. Nonetheless, most CLTs have wanted to carry their own liability insurance covering whatever residual liability they might still bear with regard to their fee interest in the property. Many CLTs, however – especially those with smaller holdings – have not been able to find reasonably priced insurance to cover just this residual liability and have therefore been forced to choose between going without such insurance and purchasing expensive policies developed for conventional landlords. CLTs with larger holdings have been more successful in negotiating policies appropriately priced for their circumstances. (CLTs should be reminded that they will need to arrange full insurance coverage for any periods of time when they have exercised a purchase option and reacquired fee simple ownership of a property.)

## Local Legal Counsel

The legal questions that arise from the creation of very long term leasehold estates and from the separation of ownership interests in buildings and land are not unique to the CLT. In fact, carefully drafted agreements, such as leases based on the Model CLT Lease, will usually be controlling whenever a question arises. Nonetheless, CLTs should consult with an experienced local real estate attorney in adapting the Model Lease for its own CLT homeownership program.

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<sup>1</sup> Piper v. Taylor, 48 N.D. 96 Y, 188 N.W. 171, 172 (1922) (real estate may be divided upon perpendicular or lateral lines); Griffin v. Fairmont Coal Co., 59 W. Va. 480, 53 S.E. (1905) (person who owns entire estate may sell and convey any part of it).

<sup>2</sup> Madison v. Madison, 206 nl. 534, 69 N.E. 625, 627 (1903) (ownership of land is not confined to surface but extends indefinitely downwards and upwards); Thorn v. Wilson, 110 Ind. 325, 11 N.E. 230, 231 (1887) (intention of parties and subject matter of agreement define nature of interest); Hahn v. Baker Lodge, A.F. & A.M., 21 Or. 30, 27 p. 166,166-67 (1891) (grant of freehold interest in part of building construed according to intention of parties). See generally, 23 Am. Jur.2d., Deeds 810.

<sup>3</sup> U.S. v. Tax Commissioner of City of New York, 254 N.Y.S. 2d. 785, 788 (N.Y. App. Div. 1964).

<sup>4</sup> National Cold Storage v. Boyland, 227 N.Y.S. 2nd. 147, 150, aff'd 236 N.Y.S. 2d. 62, 187 N.E.2d. 129 (N.Y. App. Div. 1962).

<sup>5</sup> 2 Powell on Real Property (MB), section 242 [1]b[ii].

<sup>6</sup> Annot., 6 A.L.R.2d. 322 (1949).

<sup>7</sup> Ibid.

<sup>8</sup> 51C C.J.S. Landlord and Tenant, section 394(3) 1968).

<sup>9</sup> Wright v. LeMay, 118 N.W. 964 (Mich. 1908); French v. N.Y., 29 Barb. 363, 16 How. Pr. 220 (N.Y. App. Div. 1859); Sanders v. Lefkovitz, 292 S.W. 596 (Texas 1927); Smusch v. Kohn, 22 Misc. 344, 49 N.Y.S. 176 (N.Y. App. Div. 1898); United Booking Offices v. Pittsburgh Life and Trust Co., 65 Misc. 31, 119 N.Y.S. 216 (N.Y. App. Div. 1909).

<sup>10</sup> Matz v. Miami Club, 127 S.W.2d. 738 (Mo. App. 1939).

<sup>11</sup> 19. Ferrell v. Ormond Mining, 176 N.C. 475, 97 S.E. 886 (1918); Root v. McFerrin, 87 Miss. 17 (1859).

<sup>12</sup> Tollefson, supra.

<sup>13</sup> 22. Pritchard v. Williams, 181 N.C. 46, 106 S.E. 144 (1921); Dunham v. Davis, 101 S.E.2d. 278 (S.C. 1957).

<sup>14</sup> Rich v. Don-Ron Trousers Corp., 343 N.Y.S.2d. 684 (1973).

<sup>15</sup> Thomas v. Barnes, 634 S.W.2d. 554 (Mo. App. 1982); Shackett v. Schwartz, 77 Mich. App. 518, 258 N.W.2d. 543 (1977).

<sup>16</sup> Powell v. United Oil Corp., 160 Ga. App. 810, 287 S.E.2d. 667 (1982i (lessor of gas station not liable for plaintiff's emotional distress when she was observed while using facilities through peephole in restroom mirror); Spinelli v. Golda, 6 N.I. 68, 77 A. 233 (1950).

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<sup>17</sup> Second Restatement of Torts, 358; Property, 17.1.

<sup>18</sup> Whalen v. Shivek, 326 Mass. 142, 93 N.E.2d. 393 (1950).

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**THE 2011 CLT NETWORK MODEL GROUND LEASE**

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*[Four possible versions of Article 10 are presented in the Appendix at the end of this chapter. These versions differ with regard to three important variables: (1) whether the homeowner is given an absolute right to select an income-qualified*

*buyer, (2) the type of resale formula that is used, and (3) whether the original Base Price is (or may be) greater than the original appraised value of the Home. No one of these versions is offered as THE model. Every CLT must make important decisions before adopting one of these versions (or its own variation of one of these versions).*

## **Version 1**

*For situations in which:*

- a) the Homeowner has no absolute right to identify buyer and can only recommend buyer;*
- b) an “improvements-only appraisal-based formula” is used; and*
- c) the original base price is not greater than the original appraised value of the Home.*

- 10.1 INTENT OF THIS ARTICLE IS TO PRESERVE AFFORDABILITY
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## **Version 2**

*For situations in which:*

- a) the Homeowner has a right to identify a buyer;*
- b) an “improvements-only appraisal-based formula” is used; and*
- c) the original base price is not greater than the original appraised value of the Home.*

- 10.1 INTENT OF THIS ARTICLE IS TO PRESERVE AFFORDABILITY
- 10.2 HOMEOWNER MAY TRANSFER HOME ONLY TO CLT OR QUALIFIED PERSONS
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**Version 3**

*For situations in which:*

- a) *the Homeowner has no absolute right to identify buyer and can only recommend buyer;*
- b) *a “compound appraisal-based formula” is used; and*
- c) *the original base price is greater than the original appraised value of the Home.*

- 10.1 INTENT OF THIS ARTICLE IS TO PRESERVE AFFORDABILITY
- 10.2 HOMEOWNER MAY TRANSFER HOME ONLY TO CLT OR QUALIFIED PERSONS
- 10.3 THE HOME MAY BE TRANSFERRED TO CERTAIN HEIRS OF HOMEOWNER
- 10.4 HOMEOWNER’S NOTICE OF INTENT TO SELL
- 10.5 AFTER RECEIVING NOTICE, CLT SHALL COMMISSION AN APPRAISAL
- 10.6 CLT HAS AN OPTION TO PURCHASE THE HOME
- 10.7 IF PURCHASE OPTION EXPIRES, HOMEOWNER MAY SELL ON CERTAIN TERMS
- 10.8 AFTER ONE YEAR CLT SHALL HAVE POWER OF ATTORNEY TO CONDUCT SALE
- 10.9 PURCHASE OPTION PRICE EQUALS LESSER OF APPRAISED VALUE OF HOMEOWNER’S OWNERSHIP INTEREST OR FORMULA PRICE
- 10.10 HOW THE FORMULA PRICE IS CALCULATED
- 10.11 QUALIFIED PURCHASER SHALL RECEIVE NEW LEASE
- 10.12 PURCHASER MAY BE CHARGED A TRANSFER FEE
- 10.13 HOMEOWNER REQUIRED TO MAKE NECESSARY REPAIRS AT TRANSFER

**Version 4**

*For situations in which:*

- a) *the Homeowner has no absolute right to identify buyer and can only recommend buyer;*
  - b) *a “fixed-rate” or “indexed” formula is used; and*
  - c) *the original base price is greater than the original appraised value of the Home.*
- Three versions of section 10.10 are presented for three different “indexed formulas.”*

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- 10.9 HOW THE VALUE OF HOMEOWNER’S OWNERSHIP INTEREST IS DETERMINED
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- 10.11 QUALIFIED PURCHASER SHALL RECEIVE NEW LEASE
- 10.12 PURCHASER MAY BE CHARGED A TRANSFER FEE
- 10.13 HOMEOWNER REQUIRED TO MAKE NECESSARY REPAIRS AT TRANSFER

**ARTICLE 11: Reserved**

**ARTICLE 12: Default**

- 12.1 WHAT HAPPENS IF HOMEOWNER FAILS TO MAKE REQUIRED PAYMENTS TO THE CLT
- 12.2 WHAT HAPPENS IF HOMEOWNER VIOLATES OTHER (NONMONETARY) TERMS OF THE LEASE
- 12.3 WHAT HAPPENS IF HOMEOWNER DEFAULTS AS A RESULT OF JUDICIAL PROCESS
- 12.4 A DEFAULT (UNCURED VIOLATION) GIVES CLT THE RIGHT TO TERMINATE THE LEASE OR EXERCISE ITS PURCHASE OPTION

**ARTICLE 13: Mediation and Arbitration**

- 13.1 MEDIATION AND ARBITRATION ARE PERMITTED
- 13.2 HOMEOWNER AND CLT SHALL SHARE COST OF ANY MEDIATION OR ARBITRATION

**ARTICLE 14: General Provisions**

- 14.1 HOMEOWNER’S MEMBERSHIP IN CLT

- 14.2 NOTICES
- 14.3 NO BROKERAGE
- 14.4 SEVERABILITY AND DURATION OF LEASE
- 14.5 RIGHT OF FIRST REFUSAL IN LIEU OF OPTION
- 14.6 WAIVER
- 14.7 CLT’S RIGHT TO PROSECUTE OR DEFEND
- 14.8 CONSTRUCTION
- 14.9 HEADINGS AND TABLE OF CONTENTS
- 14.10 PARTIES BOUND
- 14.11 GOVERNING LAW
- 14.12 RECORDING

**Exhibits That Must Be Attached**

- Exhibit LETTERS OF AGREEMENT AND ATTORNEY’S ACKNOWLEDGMENT
- Exhibit LEASED LAND
- Exhibit DEED
- Exhibit PERMITTED MORTGAGES
- Exhibit FIRST REFUSAL

**Other Exhibits to be Attached as Appropriate**

- Exhibit ZONING
- Exhibit RESTRICTIONS
- Exhibit INITIAL APPRAISAL

**APPENDIX: Alternative versions of Article 10**

**MODEL CLT LEASE**

THIS LEASE (“this Lease” or “the Lease”) entered into this \_\_\_\_\_ day of \_\_\_\_\_, 20\_\_\_\_, between \_\_\_\_\_ COMMUNITY LAND TRUST (“CLT”) and \_\_\_\_\_ (“Homeowner”).

**RECITALS**

- A.** The CLT is organized exclusively for charitable purposes, including the purpose of providing homeownership opportunities for low and moderate income people who would otherwise be unable to afford homeownership.
- B.** A goal of the CLT is to preserve affordable homeownership opportunities through the long-term leasing of land under owner-occupied homes.
- C.** The Leased Land described in this Lease has been acquired and is being leased by the CLT in furtherance of this goal.

**D.** The Homeowner shares the purposes of the CLT and has agreed to enter into this Lease not only to obtain the benefits of homeownership, but also to further the charitable purposes of the CLT.

**E.** Homeowner and CLT recognize the special nature of the terms of this Lease, and each of them accepts these terms, including those terms that affect the marketing and resale price of the property now being purchased by the Homeowner.

**F.** Homeowner and CLT agree that the terms of this Lease further their shared goals over an extended period of time and through a succession of owners.

**NOW THEREFORE**, Homeowner and CLT agree on all of the terms and conditions of this Lease as set forth below.

**DEFINITIONS:** Homeowner and CLT agree on the following definitions of key terms used in this Lease.

*Leased Land:* the parcel of land, described in Exhibit: LEASED LAND, that is leased to the Homeowner.

*Home:* the residential structure and other permanent improvements located on the Leased Land and owned by the Homeowner, including both the original Home described in Exhibit: DEED, and all permanent improvements added thereafter by Homeowner at Homeowner's expense.

*Base Price:* the total price that is paid for the Home by the Homeowner (including the amount provided by a first mortgage loan but not including subsidy in the form of deferred loans to the Homeowner).

*Purchase Option Price:* the maximum price the Homeowner is allowed to receive for the sale of the Home and the Homeowner's right to possess, occupy and use the Leased Land, as defined in Article 10 of this Lease.

*Lease Fee:* The monthly fee that the Homeowner pays to the CLT for the continuing use of the Leased Land and any additional amounts that the CLT charges to the Homeowner for reasons permitted by this Lease.

*Permitted Mortgage:* A mortgage or deed of trust on the Home and the Homeowner's right to possess, occupy and use the Leased Land granted to a lender by the Homeowner with the CLT's Permission. The Homeowner may not mortgage the CLT's interest in the Leased Land, and may not grant any mortgage or deed of trust without CLT's Permission.

*Event of Default:* Any violation of the terms of the Lease unless it has been corrected ("cured") by Homeowner or the holder of a Permitted Mortgage in the specified period of time after a written Notice of Default has been given by CLT.

**ARTICLE 1: Homeowner's Letter of Agreement and Attorney's Letter of Acknowledgment are Attached as Exhibits.**

Attached as Exhibit HOMEOWNER'S LETTER OF AGREEMENT AND ATTORNEY'S LETTER OF ACKNOWLEDGMENT and made part of this Lease by reference are a Letter of Agreement from the Homeowner, describing the Homeowner's understanding and acceptance of this Lease (including the parts of the Lease that affect the

resale of the Home), and a Letter of Acknowledgment from the Homeowner's attorney, describing the attorney's review of the Lease with the Homeowner.

## **ARTICLE 2: Leasing of Rights to the Land**

2.1 CLT LEASES THE LAND TO HOMEOWNER: The CLT hereby leases to the Homeowner, and Homeowner hereby accepts, the right to possess, occupy and use the Leased Land (described in the attached Exhibit LEASED LAND) in accordance with the terms of this Lease. CLT has furnished to Homeowner a copy of the most current title report, if any, obtained by CLT for the Leased Land, and Homeowner accepts title to the Leased Land in its condition "as is" as of the signing of this Lease.

2.2 MINERAL RIGHTS NOT LEASED TO HOMEOWNER: CLT does not lease to Homeowner the right to remove from the Leased Land any minerals lying beneath the Leased Land's surface. Ownership of such minerals remains with the CLT, but the CLT shall not remove any such minerals from the Leased Land without the Homeowner's written permission.

## **ARTICLE 3: Term of Lease, Change of Land Owner**

3.1 TERM OF LEASE IS 99 YEARS: This Lease shall remain in effect for 99 years, beginning on the \_\_\_ day of \_\_\_\_\_, 20\_\_\_, and ending on the \_\_\_\_\_ day of \_\_\_\_\_, 20\_\_\_, unless ended sooner or renewed as provided below.

3.2 HOMEOWNER CAN RENEW LEASE FOR ANOTHER 99 YEARS: Homeowner may renew this Lease for one additional period of 99 years. The CLT may change the terms of the Lease for the renewal period prior to the beginning of the renewal period but only if these changes do not materially and adversely interfere with the rights possessed by Homeowner under the Lease. Not more than 365 nor less than 180 days before the last day of the first 99-year period, CLT shall give Homeowner a written notice that states the date of the expiration of the first 99-year period and the conditions for renewal as set forth in the following paragraph ("the Expiration Notice"). The Expiration Notice shall also describe any changes that CLT intends to make in the Lease for the renewal period as permitted above.

The Homeowner shall then have the right to renew the Lease only if the following conditions are met: (a) within 60 days of receipt of the Expiration Notice, the Homeowner shall give CLT written notice stating the Homeowner's desire to renew ("the Renewal Notice"); (b) this Lease shall be in effect on the last day of the original 99-year term, and (c) the Homeowner shall not be in default under this Lease or under any Permitted Mortgage on the last day of the original 99-year term.

When Homeowner has exercised the option to renew, Homeowner and CLT shall sign a memorandum stating that the option has been exercised. The memorandum shall comply with the requirements for a notice of lease as stated in Section 14.12 below. The CLT shall record this memorandum in accordance with the requirements of law promptly after the beginning of the renewal period.

3.3 WHAT HAPPENS IF CLT DECIDES TO SELL THE LEASED LAND: If ownership of the Leased Land is ever transferred by CLT (whether voluntarily or involuntarily) to any other person or institution, this Lease shall not cease, but shall remain binding on the new landowner as well as the Homeowner. If CLT agrees to transfer the Leased Land to any person or

institution other than a non-profit corporation, charitable trust, government agency or other similar institution sharing the goals described in the Recitals above, the Homeowner shall have a right of first refusal to purchase the Leased Land. The details of this right shall be as stated in the attached Exhibit FIRST REFUSAL. Any sale or other transfer contrary to this Section 3.3 shall be null and void.

#### **ARTICLE 4: Use of Leased Land**

4.1 HOMEOWNER MAY USE THE HOME ONLY FOR RESIDENTIAL AND RELATED PURPOSES: Homeowner shall use, and allow others to use, the Home and Leased Land only for residential purposes and any activities related to residential use that were permitted by local zoning law when the Lease was signed, as indicated in the attached Exhibit ZONING.

[*To be added when needed:* Use of the Leased Land shall be further limited by the restrictions described in the attached Exhibit RESTRICTIONS.]

4.2 HOMEOWNER MUST USE THE HOME AND LEASED LAND RESPONSIBLY AND IN COMPLIANCE WITH THE LAW: Homeowner shall use the Home and Leased Land in a way that will not cause harm to others or create any public nuisance. Homeowner shall dispose of all waste in a safe and sanitary manner. Homeowner shall maintain all parts of the Home and Leased Land in safe, sound and habitable condition, in full compliance with all laws and regulations, and in the condition that is required to maintain the insurance coverage required by Section 9.4 of this Lease.

4.3 HOMEOWNER IS RESPONSIBLE FOR USE BY OTHERS: Homeowner shall be responsible for the use of the Home and Leased Land by all residents and visitors and anyone else using the Leased Land with Homeowner's permission and shall make all such people aware of the restrictions on use set forth in this Lease.

4.4 HOMEOWNER MUST OCCUPY THE HOME FOR AT LEAST \_\_ MONTHS EACH YEAR: Homeowner shall occupy the Home for at least \_\_\_\_\_ months of each year of this Lease, unless otherwise agreed by CLT. Occupancy by Homeowner's child, spouse [*or domestic partner, in states with such legislation*] or other persons approved by CLT shall be considered occupancy by Homeowner. Neither compliance with the occupancy requirement nor CLT's permission for an extended period of non-occupancy constitutes permission to sublease the Leased Land and Home, which is addressed in Section 4.5 below.

4.5 LEASED LAND MAY NOT BE SUBLEASED WITHOUT CLT'S PERMISSION. Except as otherwise provided in Article 8 and Article 10, Homeowner shall not sublease, sell or otherwise convey any of Homeowner's rights under this Lease, for any period of time, without the written permission of CLT. Homeowner agrees that CLT shall have the right to withhold such consent in order to further the purposes of this Lease.

If permission for subleasing is granted, the sublease shall be subject to the following conditions.

- a) Any sublease shall be subject to all of the terms of this Lease.
- b) The rental or occupancy fee charged the sub-lessee shall not be more than the amount of the Lease Fee charged the Homeowner by the CLT, plus an amount approved by CLT to cover Homeowner's costs in owning the Home, including but not limited to the cost of taxes, insurance and mortgage interest.

**4.6 CLT HAS A RIGHT TO INSPECT THE LEASED LAND:** The CLT may inspect any part of the Leased Land except the interiors of fully enclosed buildings, at any reasonable time, after notifying the Homeowner at least 24 hours before the planned inspection. No more than \_\_\_\_ regular inspections may be carried out in a single year, except in the case of an emergency. In an emergency, the CLT may inspect any part of the Leased Land except the interiors of fully enclosed buildings, after making reasonable efforts to inform the Homeowner before the inspection.

If the CLT has received an Intent-To-Sell Notice (as described in Section 10.4 below), then the CLT has the right to inspect the interiors of all fully enclosed buildings to determine their condition prior to the sale. The CLT must notify the Homeowner at least 24 hours before carrying out such inspection.

**4.7 HOMEOWNER HAS A RIGHT TO QUIET ENJOYMENT:** Homeowner has the right to quiet enjoyment of the Leased Land. The CLT has no desire or intention to interfere with the personal lives, associations, expressions, or actions of the Homeowner in any way not permitted by this Lease.

#### **ARTICLE 5: Lease Fee**

**5.1 AMOUNT OF LEASE FEE:** The Homeowner shall pay a monthly Lease Fee in an amount equal to the sum of (a) a Land Use Fee of \$ \_\_\_\_ to be paid in return for the continuing right to possess, occupy and use the Leased Land, plus (b) a Repair Reserve Fee of \$ \_\_\_\_ to be held by the CLT and used for the purpose of preserving the physical quality of the Home for the long term in accordance with Section 7.6 below.

**5.2 WHEN THE LEASE FEE IS TO BE PAID:** The Lease Fee shall be payable to CLT on the first day of each month for as long as this Lease remains in effect, unless the Lease Fee is to be escrowed and paid by a Permitted Mortgagee, in which case payment shall be made as directed by that Mortgagee.

**5.3 HOW THE AMOUNT OF THE LAND USE FEE HAS BEEN DETERMINED:** The amount of the Land Use Fee stated in Section 5.1 above has been determined as follows. First, the approximate monthly fair rental value of the Leased Land has been established, as of the beginning of the Lease term, recognizing that the fair rental value is reduced by certain restrictions imposed by the Lease on the use of the Land. Then the affordability of this monthly amount, plus the amount of the Repair Reserve Fee, for the Homeowner has been analyzed and, if necessary, the Land Use has been reduced to an amount considered to be affordable for Homeowner.

**5.4 CLT MAY REDUCE OR SUSPEND THE LEASE FEE TO IMPROVE AFFORDABILITY:** CLT may reduce or suspend the total amount of the Lease Fee for a period of time for the purpose of improving the affordability of the Homeowner's monthly housing costs. Any such reduction or suspension must be in writing and signed by CLT.

**5.5 FEES MAY BE INCREASED FROM TIME TO TIME:** The CLT may increase the amount of the Land Use Fee and/or the Repair Reserve Fee from time to time, but not more often than once every \_\_\_\_ years. Each time such amounts are increased, the total percentage of increase since the date this Lease was signed shall not be greater than the percentage of increase, over the same period of time, in the Consumer Price Index for urban wage earners

and clerical workers for the urban area in which the Leased Land is located, or, if none, for urban areas the size of \_\_\_\_\_.

**5.6 LAND USE FEE WILL BE INCREASED IF RESTRICTIONS ARE REMOVED:** If, for any reason, the provisions of Article 10 regarding transfers of the Home or Sections 4.4 and 4.5 regarding occupancy and subleasing are suspended or invalidated for any period of time, then during that time the Land Use Fee shall be increased to an amount calculated by CLT to equal the fair rental value of the Leased Land for use not restricted by the suspended provisions, but initially an amount not exceeding \_\_\_\_ dollars. Such increase shall become effective upon CLT's written notice to Homeowner. Thereafter, for so long as these restrictions are not reinstated in the Lease, the CLT may, from time to time, further increase the amount of such Land Use Fee, provided that the amount of the Land Use Fee does not exceed the fair rental value of the property, and provided that such increases do not occur more often than once in every \_\_\_\_ years.

**5.7 IF PAYMENT IS LATE, INTEREST CAN BE CHARGED:** If the CLT has not received any monthly installment of the Lease Fee on or before the date on which the such installment first becomes payable under this Lease (the "Due Date"), the CLT may require Homeowner to pay interest on the unpaid amount from the Due Date through and including the date such payment or installment is received by CLT, at a rate not to exceed \_\_\_\_ *[Specify either a fixed %, an index such as prime rate of a particular institution, or a legally established limit]*. Such interest shall be deemed additional Lease Fee and shall be paid by Homeowner to CLT upon demand; provided, however, that CLT shall waive any such interest that would otherwise be payable to CLT if such payment of the Lease Fee is received by CLT on or before the thirtieth (30<sup>th</sup>) day after the Due Date.

**5.8 CLT CAN COLLECT UNPAID FEES WHEN HOME IS SOLD:** In the event that any amount of payable Lease Fee remains unpaid when the Home is sold, the outstanding amount of payable Lease Fee, including any interest as provided above, shall be paid to CLT out of any proceeds from the sale that would otherwise be due to Homeowner. The CLT shall have, and the Homeowner hereby consents to, a lien upon the Home for any unpaid Lease Fee. Such lien shall be prior to all other liens and encumbrances on the Home except (a) liens and encumbrances recorded before the recording of this Lease, (b) Permitted Mortgages as defined in section 8.1 below; and (c) liens for real property taxes and other governmental assessments or charges against the Home.

#### **ARTICLE 6: Taxes and Assessments**

**6.1 HOMEOWNER IS RESPONSIBLE FOR PAYING ALL TAXES AND ASSESSMENTS:** Homeowner shall pay directly, when due, all taxes and governmental assessments that relate to the Home and the Leased Land (including any taxes relating to the CLT's interest in the Leased Land).

**6.2 CLT WILL PASS ON ANY TAX BILLS IT RECEIVES TO HOMEOWNER:** In the event that the local taxing authority bills CLT for any portion of the taxes on the Home or Leased Land, CLT shall pass the bill to Homeowner and Homeowner shall promptly pay this bill.

**6.3 HOMEOWNER HAS A RIGHT TO CONTEST TAXES:** Homeowner shall have the right to contest the amount or validity of any taxes relating to the Home and Leased Land. Upon receiving a reasonable request from Homeowner for assistance in this matter, CLT shall join in contesting such taxes. All costs of such proceedings shall be paid by Homeowner.

**6.4 IF HOMEOWNER FAILS TO PAY TAXES, CLT MAY INCREASE LEASE FEE:** In the event that Homeowner fails to pay the taxes or other charges described in Section 6.1 above, CLT may increase Homeowner's Lease Fee to offset the amount of taxes and other charges owed by Homeowner. Upon collecting any such amount, CLT shall pay the amount collected to the taxing authority in a timely manner.

**6.5 PARTY THAT PAYS TAXES MUST SHOW PROOF:** When either party pays taxes relating to the Home or Leased Land, that party shall furnish satisfactory evidence of the payment to the other party. A photocopy of a receipt shall be the usual method of furnishing such evidence.

#### **ARTICLE 7: The Home**

**7.1 HOMEOWNER OWNS THE HOUSE AND ALL OTHER IMPROVEMENTS ON THE LEASED LAND:** All structures, including the house, fixtures, and other improvements purchased, constructed, or installed by the Homeowner on any part of the Leased Land at any time during the term of this Lease (collectively, the "Home") shall be property of the Homeowner. Title to the Home shall be and remain vested in the Homeowner. However, Homeowner's rights of ownership are limited by certain provisions of this Lease, including provisions regarding the sale or leasing of the Home by the Homeowner and the CLT's option to purchase the Home. In addition, Homeowner shall not remove any part of the Home from the Leased Land without CLT's prior written consent.

**7.2 HOMEOWNER PURCHASES HOME WHEN SIGNING LEASE:** Upon the signing of this Lease, Homeowner is simultaneously purchasing the Home located at that time on the Leased Land, as described in the Deed, a copy of which is attached to this Lease as Exhibit: DEED.

**7.3 CONSTRUCTION CARRIED OUT BY HOMEOWNER MUST COMPLY WITH CERTAIN REQUIREMENTS:** Any construction in connection with the Home is permitted only if the following requirements are met: (a) all costs shall be paid for by the Homeowner; (b) all construction shall be performed in a professional manner and shall comply with all applicable laws and regulations; (c) all changes in the Home shall be consistent with the permitted uses described in Article 4; (d) the footprint, square-footage, or height of the house shall not be increased and new structures shall not be built or installed on the Leased Land without the prior written consent of CLT.

For any construction requiring CLT's prior written consent, Homeowner shall submit a written request to the CLT. Such request shall include:

- a) a written statement of the reasons for undertaking the construction;
- b) a set of drawings (floor plan and elevations) showing the dimensions of the proposed construction;
- c) a list of the necessary materials, with quantities needed;

d) a statement of who will do the work;

If the CLT finds it needs additional information it shall request such information from Homeowner within two weeks of receipt of Homeowner's request. The CLT then, within two weeks of receiving all necessary information (including any additional information it may have requested) shall give Homeowner either its written consent or a written statement of its reasons for not consenting. Before construction can begin, Homeowner shall provide CLT with copies of all necessary building permits, if not previously provided.

**7.4 HOMEOWNER MAY NOT ALLOW STATUTORY LIENS TO REMAIN AGAINST LEASED LAND OR HOME:** No lien of any type shall attach to the CLT's title to the Leased Land. Homeowner shall not permit any statutory or similar lien to be filed against the Leased Land or the Home which remains more than 60 days after it has been filed. Homeowner shall take action to discharge such lien, whether by means of payment, deposit, bond, court order, or other means permitted by law. If Homeowner fails to discharge such lien within the 60-day period, then Homeowner shall immediately notify CLT of such failure. CLT shall have the right to discharge the lien by paying the amount in question. Homeowner may, at Homeowner's expense, contest the validity of any such asserted lien, provided Homeowner has furnished a bond or other acceptable surety in an amount sufficient to release the Leased Land from such lien. Any amounts paid by CLT to discharge such liens shall be treated as an additional Lease Fee payable by Homeowner upon demand.

**7.5 HOMEOWNER IS RESPONSIBLE FOR SERVICES, MAINTENANCE AND REPAIRS:** Homeowner hereby assumes responsibility for furnishing all services or facilities on the Leased Land, including but not limited to heat, electricity, air conditioning and water. CLT shall not be required to furnish any services or facilities or to make any repairs to the Home. Homeowner shall maintain the Home and Leased Land as required by Section 4.2 above and shall see that all necessary repairs and replacements are accomplished when needed.

**7.6 A REPAIR RESERVE FUND IS ESTABLISHED TO SUPPORT FUTURE REPAIRS:**  
***[This section must either be completed in accordance with the CLT's repair reserve policy, or omitted entirely. See Commentary on this Section 7.6.]***

**7.7 WHEN LEASE ENDS, OWNERSHIP REVERTS TO CLT, WHICH SHALL REIMBURSE HOMEOWNER:** Upon the expiration or termination of this Lease, ownership of the Home shall revert to CLT. Upon thus assuming title to the Home, CLT shall promptly pay Homeowner and Permitted Mortgagee(s), as follows:

FIRST, CLT shall pay any Permitted Mortgagee(s) the full amount owed to such mortgagee(s) by Homeowner;

SECOND, CLT shall pay the Homeowner the balance of the Purchase Option Price calculated in accordance with Article 10 below, as of the time of reversion of ownership, less the total amount of any unpaid Lease Fee and any other amounts owed to the CLT under the terms of this Lease. The Homeowner shall be responsible for any costs necessary to clear any additional liens or other charges related to the Home which may be assessed against the Home. If the Homeowner fails to clear such liens or charges, the balance due the Homeowner shall also be reduced by the amount necessary to release such liens or charges, including reasonable attorneys fees incurred by the CLT.

**ARTICLE 8: Financing**

8.1 HOMEOWNER CANNOT MORTGAGE THE HOME WITHOUT CLT'S PERMISSION: The Homeowner may mortgage the Home only with the written permission of CLT. Any mortgage or deed of trust permitted in writing by the CLT is defined as a Permitted Mortgage, and the holder of such a mortgage or deed of trust is defined as a Permitted Mortgagee.

8.2 BY SIGNING LEASE, CLT GIVES PERMISSION FOR ORIGINAL MORTGAGE. By signing this Lease, CLT gives written permission for any mortgage or deed of trust signed by the Homeowner effective on the day this Lease is signed for the purpose of financing Homeowner's purchase of the Home.

8.3 HOMEOWNER MUST GET SPECIFIC PERMISSION FOR REFINANCING OR OTHER SUBSEQUENT MORTGAGES. If, at any time subsequent to the purchase of the Home and signing of the Lease, the Homeowner seeks a loan that is to be secured by a mortgage on the Home (to refinance an existing Permitted Mortgage or to finance home repairs or for any other purpose), Homeowner must inform CLT, in writing, of the proposed terms and conditions of such mortgage loan at least 15 business days prior to the expected closing of the loan. The information to be provided to the CLT must include:

- a. the name of the proposed lender;
- b. Homeowner's reason for requesting the loan;
- c. the principal amount of the proposed loan and the total mortgage debt that will result from the combination of the loan and existing mortgage debt, if any;
- d. expected closing costs;
- e. the rate of interest;
- f. the repayment schedule;
- g. a copy of the appraisal commissioned in connection with the loan request.

CLT may also require Homeowner to submit additional information. CLT will not permit such a mortgage loan if the loan increases Homeowner's total mortgage debt to an amount greater than   % of the then current Purchase Option Price, calculated in accordance with Article 10 below, or if the terms of the transaction otherwise threaten the interests of either the Homeowner or the CLT.

8.4 CLT IS REQUIRED TO PERMIT A "STANDARD PERMITTED MORTGAGE." The CLT shall be required to permit any mortgage for which the mortgagee has signed a "Standard Permitted Mortgage Agreement" as set forth in "Exhibit: Permitted Mortgages, Part C," and for which the loan secured thereby does not increase Homeowner's total mortgage debt to an amount greater than   % of the then current Purchase Option Price, calculated in accordance with Article 10 below.

8.5 A PERMITTED MORTGAGEE HAS CERTAIN OBLIGATIONS UNDER THE LEASE. Any Permitted Mortgagee shall be bound by each of the requirements stated in "Exhibit: Permitted Mortgages, Part A, Obligations of Permitted Mortgagee," which is made a part of this Lease by reference, unless the particular requirement is removed, contradicted or modified by a Rider to this Lease signed by the Homeowner and the CLT to modify the terms of the Lease during the term of the Permitted Mortgage.

8.6 A PERMITTED MORTGAGEE HAS CERTAIN RIGHTS UNDER THE LEASE. Any Permitted Mortgagee shall have all of the rights and protections stated in “Exhibit: Permitted Mortgages, Part B, Rights of Permitted Mortgagee,” which is made a part of this Lease by reference.

8.7 IN THE EVENT OF FORECLOSURE, ANY PROCEEDS IN EXCESS OF THE PURCHASE OPTION PRICE WILL GO TO CLT. Homeowner and CLT recognize that it would be contrary to the purposes of this agreement if Homeowner could receive more than the Purchase Option Price as the result of the foreclosure of a mortgage. Therefore, Homeowner hereby irrevocably assigns to CLT all net proceeds of sale of the Home that would otherwise have been payable to Homeowner and that exceed the amount of net proceeds that Homeowner would have received if the property had been sold for the Purchase Option Price, calculated as described in Section 10.10 below. Homeowner authorizes and instructs the Permitted Mortgagee, or any party conducting any sale, to pay such excess amount directly to CLT. If, for any reason, such excess amount is paid to Homeowner, Homeowner hereby agrees to promptly pay such amount to CLT.

#### **ARTICLE 9: Liability, Insurance, Damage and Destruction, Eminent Domain**

9.1 HOMEOWNER ASSUMES ALL LIABILITY. Homeowner assumes all responsibility and liability related to Homeowner’s possession, occupancy and use of the Leased Land.

9.2 HOMEOWNER MUST DEFEND CLT AGAINST ALL CLAIMS OF LIABILITY. Homeowner shall defend, indemnify and hold CLT harmless against all liability and claims of liability for injury or damage to person or property from any cause on or about the Leased Land. Homeowner waives all claims against CLT for injury or damage on or about the Leased Land. However, CLT shall remain liable for injury or damage due to the grossly negligent or intentional acts or omissions of CLT or CLT’s agents or employees.

9.3 HOMEOWNER MUST REIMBURSE CLT. In the event the CLT shall be required to pay any sum that is the Homeowner’s responsibility or liability, the Homeowner shall reimburse the CLT for such payment and for reasonable expenses caused thereby.

9.4 HOMEOWNER MUST INSURE THE HOME AGAINST LOSS AND MUST MAINTAIN LIABILITY INSURANCE ON HOME AND LEASED LAND. Homeowner shall, at Homeowner’s expense, keep the Home continuously insured against “all risks” of physical loss, using Insurance Services Office (ISO) Form HO 00 03, or its equivalent, for the full replacement value of the Home, and in any event in an amount that will not incur a coinsurance penalty. The amount of such insured replacement value must be approved by the CLT prior to the commencement of the Lease. Thereafter, if the CLT determines that the replacement value to be insured should be increased, the CLT shall inform the Homeowner of such required increase at least 30 days prior to the next date on which the insurance policy is to be renewed, and the Homeowner shall assure that the renewal includes such change. If Homeowner wishes to decrease the amount of replacement value to be insured, Homeowner shall inform the CLT of the proposed change at least 30 days prior to the time such change would take effect. The change shall not take effect without CLT’s approval.

Should the Home lie in a flood hazard zone as defined by the National Flood Insurance Plan, the Homeowner shall keep in full force and effect flood insurance in the maximum amount available.

The Homeowner shall also, at its sole expense, maintain in full force and effect public liability insurance using ISO Form HO 00 03 or its equivalent in the amount of \$\_\_\_\_\_ per occurrence and in the aggregate. The CLT shall be named as an additional insured using ISO Form HO 04 41 or its equivalent, and certificates of insurance shall be delivered to the CLT prior to the commencement of the Lease and at each anniversary date thereof.

The dollar amounts of such coverage may be increased from time to time at the CLT's request but not more often than once in any one-year period. CLT shall inform the Homeowner of such required increase in coverage at least 30 days prior to the next date on which the insurance policy is to be renewed, and the Homeowner shall assure that the renewal includes such change. The amount of such increase in coverage shall be based on current trends in homeowner's liability insurance coverage in the area in which the Home is located.

**9.5 WHAT HAPPENS IF HOME IS DAMAGED OR DESTROYED.** Except as provided below, in the event of fire or other damage to the Home, Homeowner shall take all steps necessary to assure the repair of such damage and the restoration of the Home to its condition immediately prior to the damage. All such repairs and restoration shall be completed as promptly as possible. Homeowner shall also promptly take all steps necessary to assure that the Leased Land is safe and that the damaged Home does not constitute a danger to persons or property.

If Homeowner, based on professional estimates, determines either (a) that full repair and restoration is physically impossible, or (b) that the available insurance proceeds will pay for less than the full cost of necessary repairs and that Homeowner cannot otherwise afford to cover the balance of the cost of repairs, then Homeowner shall notify CLT of this problem, and CLT may then help to resolve the problem. Methods used to resolve the problem may include efforts to increase the available insurance proceeds, efforts to reduce the cost of necessary repairs, efforts to arrange affordable financing covering the costs of repair not covered by insurance proceeds, and any other methods agreed upon by both Homeowner and CLT.

If Homeowner and CLT cannot agree on a way of restoring the Home in the absence of adequate insurance proceeds, then Homeowner may give CLT written notice of intent to terminate the Lease. The date of actual termination shall be no less than 60 days after the date of Homeowner's notice of intent to terminate. Upon termination, any insurance proceeds payable to Homeowner for damage to the Home shall be paid as follows.

FIRST, to the expenses of their collection;

SECOND, to any Permitted Mortgagee(s), to the extent required by the Permitted Mortgagee(s);

THIRD, to the expenses of enclosing or razing the remains of the Home and clearing debris;

FOURTH, to the CLT for any amounts owed under this Lease;

FIFTH, to the Homeowner, up to an amount equal to the Purchase Option Price, as of the day prior to the loss, less any amounts paid with respect to the second, third, and fourth clauses above;

SIXTH, the balance, if any, to the CLT.

9.6 WHAT HAPPENS IF SOME OR ALL OF THE LAND IS TAKEN FOR PUBLIC USE. If all of the Leased Land is taken by eminent domain or otherwise for public purposes, or if so much of the Leased Land is taken that the Home is lost or damaged beyond repair, the Lease shall terminate as of the date when Homeowner is required to give up possession of the Leased Land. Upon such termination, the entire amount of any award(s) paid shall be allocated in the way described in Section 9.5 above for insurance proceeds.

In the event of a taking of a portion of the Leased Land that does not result in damage to the Home or significant reduction in the usefulness or desirability of the Leased Land for residential purposes, then any monetary compensation for such taking shall be allocated entirely to CLT.

In the event of a taking of a portion of the Leased Land that results in damage to the Home only to such an extent that the Home can reasonably be restored to a residential use consistent with this Lease, then the damage shall be treated as damage is treated in Section 9.5 above, and monetary compensation shall be allocated as insurance proceeds are to be allocated under Section 9.5.

9.7 IF PART OF THE LAND IS TAKEN, THE LEASE FEE MAY BE REDUCED. In the event of any taking that reduces the size of the Leased Land but does not result in the termination of the Lease, CLT shall reassess the fair rental value of the remaining Land and shall adjust the Lease Fee if necessary to assure that the monthly fee does not exceed the monthly fair rental value of the Land for use as restricted by the Lease.

9.8 IF LEASE IS TERMINATED BY DAMAGE, DESTRUCTION OR TAKING, CLT WILL TRY TO HELP HOMEOWNER BUY ANOTHER CLT HOME. If this Lease is terminated as a result of damage, destruction or taking, CLT shall take reasonable steps to allow Homeowner to purchase another home on another parcel of leased land owned by CLT if such home can reasonably be made available. If Homeowner purchases such a home, Homeowner agrees to apply any proceeds or award received by Homeowner to the purchase of the home. Homeowner understands that there are numerous reasons why it may not be possible to make such a home available, and shall have no claim against CLT if such a home is not made available.

#### **ARTICLE 10: Transfer of the Home**

*[Four possible versions of Article 10 are presented in the Appendix at the end of this chapter. A CLT may adopt one or another version (or a variation of a version) depending on: (a) the specific resale formula used, (b) whether the Homeowner is to have an absolute right to select an income-qualified buyer, and (c) the relationship of the base price to the market value of the Home.]*

#### **ARTICLE 11: RESERVED**

#### **ARTICLE 12: DEFAULT**

12.1 WHAT HAPPENS IF HOMEOWNER FAILS TO MAKE PAYMENTS TO THE CLT THAT ARE REQUIRED BY THE LEASE: It shall be an event of default if Homeowner fails to pay the Lease Fee or other charges required by the terms of this Lease and such failure is not cured by Homeowner or a Permitted Mortgagee within thirty (30) days after notice of

such failure is given by CLT to Homeowner and Permitted Mortgagee. However, if Homeowner makes a good faith partial payment of at least two-thirds (2/3) of the amount owed during the 30-day cure period, then the cure period shall be extended by an additional 30 days.

**12.2 WHAT HAPPENS IF HOMEOWNER VIOLATES OTHER (NONMONETARY) TERMS OF THE LEASE:** It shall be an event of default if Homeowner fails to abide by any other requirement or restriction stated in this Lease, and such failure is not cured by Homeowner or a Permitted Mortgagee within sixty (60) days after notice of such failure is given by CLT to Homeowner and Permitted Mortgagee. However, if Homeowner or Permitted Mortgagee has begun to cure such default within the 60-day cure period and is continuing such cure with due diligence but cannot complete the cure within the 60-day cure period, the cure period shall be extended for as much additional time as may be reasonably required to complete the cure.

**12.3 WHAT HAPPENS IF HOMEOWNER DEFAULTS AS A RESULT OF JUDICIAL PROCESS:** It shall be an event of default if the estate hereby created is taken on execution or by other process of law, or if Homeowner is judicially declared bankrupt or insolvent according to law, or if any assignment is made of the property of Homeowner for the benefit of creditors, or if a receiver, trustee in involuntary bankruptcy or other similar officer is appointed to take charge of any substantial part of the Home or Homeowner's interest in the Leased Land by a court of competent jurisdiction, or if a petition is filed for the reorganization of Homeowner under any provisions of the Bankruptcy Act now or hereafter enacted, or if Homeowner files a petition for such reorganization, or for arrangements under any provision of the Bankruptcy Act now or hereafter enacted and providing a plan for a debtor to settle, satisfy or extend the time for payment of debts.

**12.4 A DEFAULT (UNCURED VIOLATION) GIVES CLT THE RIGHT TO TERMINATE THE LEASE OR EXERCISE ITS PURCHASE OPTION:**

a) **TERMINATION:** In the case of any of the events of default described above, CLT may terminate this lease and initiate summary proceedings under applicable law against Homeowner, and CLT shall have all the rights and remedies consistent with such laws and resulting court orders to enter the Leased Land and Home and repossess the entire Leased Land and Home, and expel Homeowner and those claiming rights through Homeowner. In addition, CLT shall have such additional rights and remedies to recover from Homeowner arrears of rent and damages from any preceding breach of any covenant of this Lease. If this Lease is terminated by CLT pursuant to an Event of Default, then, as provided in Section 7.7 above, upon thus assuming title to the Home, CLT shall pay to Homeowner and any Permitted Mortgagee an amount equal to the Purchase Option Price calculated in accordance with Section 10.9 above, as of the time of reversion of ownership, less the total amount of any unpaid Lease Fee and any other amounts owed to the CLT under the terms of this Lease and all reasonable costs (including reasonable attorneys' fees) incurred by CLT in pursuit of its remedies under this Lease.

If CLT elects to terminate the Lease, then the Permitted Mortgagee shall have the right (subject to Article 8 above and the attached Exhibit: Permitted Mortgages) to postpone and extend the specified date for the termination of the Lease for a period sufficient to enable the

Permitted Mortgagee or its designee to acquire Homeowner’s interest in the Home and the Leased Land by foreclosure of its mortgage or otherwise.

b) EXERCISE OF OPTION: In the case of any of the events of default described above, Homeowner hereby grants to the CLT (or its assignee) the option to purchase the Home for the Purchase Option Price as such price is defined in Article 10 above. Within thirty (30) days after the expiration of any applicable cure period as established in Sections 12.1 or 12.2 above or within 30 days after any of the events constituting an Event of Default under Section 12.3 above, CLT shall notify the Homeowner and the Permitted Mortgagee(s) of its decision to exercise its option to purchase under this Section 12.4(b). Not later than ninety (90) days after the CLT gives notice to the Homeowner of the CLT’s intent to exercise its option under this Section 12.4(a), the CLT or its assignee shall purchase the Home for the Purchase Option Price.

12.5 WHAT HAPPENS IF CLT DEFAULTS: CLT shall in no event be in default in the performance of any of its obligations under the Lease unless and until CLT has failed to perform such obligations within sixty (60) days, or such additional time as is reasonably required to correct any default, after notice by Homeowner to CLT properly specifying CLT’s failure to perform any such obligation.

**ARTICLE 13: Mediation and Arbitration**

13.1 Nothing in this Lease shall be construed as preventing the parties from utilizing any process of mediation or arbitration in which the parties agree to engage for the purpose of resolving a dispute.

13.2 Homeowner and CLT shall each pay one half (50%) of any costs incurred in carrying out mediation or arbitration in which the parties have agreed to engage.

**ARTICLE 14: GENERAL PROVISIONS**

14.1 HOMEOWNER’S MEMBERSHIP IN CLT: The Homeowner under this Lease shall automatically be a regular voting member of the CLT.

14.2 NOTICES: Whenever this Lease requires either party to give notice to the other, the notice shall be given in writing and delivered in person or mailed, by certified or registered mail, return receipt requested, to the party at the address set forth below, or such other address designated by like written notice:

If to CLT: \_\_\_\_\_ (name of CLT)  
 with a copy to: \_\_\_\_\_ (CLT’s attorney)

If to Homeowner: \_\_\_\_\_ (name of Homeowner)

All notices, demands and requests shall be effective upon being deposited in the United States Mail or, in the case of personal delivery, upon actual receipt.

14.3 NO BROKERAGE: Homeowner warrants that it has not dealt with any real estate broker other than \_\_\_\_\_ in connection with the purchase of the Home. If any claim is made against CLT regarding dealings with brokers other than \_\_\_\_\_, Homeowner shall defend CLT against such claim with counsel of CLT’s selection and shall reimburse CLT for any loss, cost or damage which may result from such claim.

14.4 SEVERABILITY AND DURATION OF LEASE: If any part of this Lease is unenforceable or invalid, such material shall be read out of this Lease and shall not affect the validity of any other part of this Lease or give rise to any cause of action of Homeowner or CLT against the other, and the remainder of this Lease shall be valid and enforced to the fullest extent permitted by law. It is the intention of the parties that CLT's option to purchase and all other rights of both parties under this Lease shall continue in effect for the full term of this Lease and any renewal thereof, and shall be considered to be coupled with an interest. In the event any such option or right shall be construed to be subject to any rule of law limiting the duration of such option or right, the time period for the exercising of such option or right shall be construed to expire twenty (20) years after the death of the last survivor of the following persons:

---

***NOTE: List an identifiable group of small children, e.g., the children living as of the date of this Lease of any of the directors or employees of a specified corporation.***

14.5 RIGHT OF FIRST REFUSAL IN LIEU OF OPTION: If the provisions of the purchase option set forth in Article 10 of this Lease shall, for any reason, become unenforceable, CLT shall nevertheless have a right of first refusal to purchase the Home at the highest documented bona fide purchase price offer made to Homeowner. Such right shall be as specified in Exhibit FIRST REFUSAL. Any sale or transfer contrary to this Section, when applicable, shall be null and void.

14.6 WAIVER: The waiver by CLT at any time of any requirement or restriction in this Lease, or the failure of CLT to take action with respect to any breach of any such requirement or restriction, shall not be deemed to be a waiver of such requirement or restriction with regard to any subsequent breach of such requirement or restriction, or of any other requirement or restriction in the Lease. CLT may grant waivers in the terms of this Lease, but such waivers must be in writing and signed by CLT before being effective.

The subsequent acceptance of Lease Fee payments by CLT shall not be deemed to be a waiver of any preceding breach by Homeowner of any requirement or restriction in this Lease, other than the failure of the Homeowner to pay the particular Lease Fee so accepted, regardless of CLT's knowledge of such preceding breach at the time of acceptance of such Lease Fee payment.

14.7 CLT'S RIGHT TO PROSECUTE OR DEFEND: CLT shall have the right, but shall have no obligation, to prosecute or defend, in its own or the Homeowner's name, any actions or proceedings appropriate to the protection of its own or Homeowner's interest in the Leased Land. Whenever requested by CLT, Homeowner shall give CLT all reasonable aid in any such action or proceeding.

14.8 CONSTRUCTION: Whenever in this Lease a pronoun is used it shall be construed to represent either the singular or the plural, masculine or feminine, as the case shall demand.

14.9 HEADINGS AND TABLE OF CONTENTS: The headings, subheadings and table of contents appearing in this Lease are for convenience only, and are not a part of this Lease and do not in any way limit or amplify the terms or conditions of this Lease.

14.10 PARTIES BOUND: This Lease sets forth the entire agreement between CLT and Homeowner with respect to the leasing of the Land; it is binding upon and inures to the

benefit of these parties and, in accordance with the provisions of this Lease, their respective successors in interest. This Lease may be altered or amended only by written notice executed by CLT and Homeowner or their legal representatives or, in accordance with the provisions of this Lease, their successors in interest.

14.11 GOVERNING LAW: This Lease shall be interpreted in accordance with and governed by the laws of \_\_\_\_\_ [name of state]. The language in all parts of this Lease shall be, in all cases, construed according to its fair meaning and not strictly for or against CLT or Homeowner.

14.12 RECORDING: The parties agree, as an alternative to the recording of this Lease, to execute a so-called Notice of Lease or Short Form Lease in form recordable and complying with applicable law and reasonably satisfactory to CLT’s attorneys. In no event shall such document state the rent or other charges payable by Homeowner under this Lease; and any such document shall expressly state that it is executed pursuant to the provisions contained in this Lease, and is not intended to vary the terms and conditions of this Lease.

IN WITNESS WHEREOF, the parties have executed this lease at \_\_\_\_\_ on the day and year first above written.

\_\_\_\_\_ (CLT)

\_\_\_\_\_  
Witness

By: \_\_\_\_\_  
Its duly authorized agent

\_\_\_\_\_ (Homeowner):

\_\_\_\_\_  
Witness

*[notarize signatures]*

**Exhibit LETTERS OF AGREEMENT AND ATTORNEY’S  
ACKNOWLEDGMENT**

***Sample***  
**Letter of Agreement**

To \_\_\_\_\_ Community Land Trust (“the CLT”)

Date: \_\_\_\_\_

This letter is given to the CLT to become an exhibit to a Lease between the CLT and me. I will be leasing a parcel of land from the CLT and will be buying the home that sits on that parcel of land. I will therefore become what is described in the Lease as a “the Homeowner.”

My legal counsel, \_\_\_\_\_, has explained to me the terms and conditions of the Lease and other legal documents that are part of this transaction. I understand the way these terms and conditions will affect my rights as a CLT homeowner, now and in the future.

In particular I understand and agree with the following points.

One of the goals of the CLT is to keep CLT homes affordable for lower income households from one CLT homeowner to the next. I support this goal as a CLT homeowner and as a member of the CLT.

The terms and conditions of my Lease will keep my home affordable for future “income-qualified persons” (as defined in the Lease). If and when I want to sell my home, the lease requires that I sell it either to the CLT or to another income-qualified person. The terms and conditions of the lease also limit the price for which I can sell the home, in order to keep it affordable for such income-qualified persons.

It is also a goal of the CLT to promote resident ownership of CLT homes. For this reason, my Lease requires that, if I and my family move out of our home permanently, we must sell it. We cannot continue to own it as absentee owners.

I understand that I can leave my home to my child or children or other members of my household and that, after my death, they can own the home for as long as they want to live in it and abide by the terms of the Lease, or they can sell it on the terms permitted by the Lease.

As a CLT homeowner and a member of the CLT, it is my desire to see the terms of the Lease and related documents honored. I consider these terms fair to me and others.

Sincerely

**Sample  
Letter of Attorney’s Acknowledgment**

I, \_\_\_\_\_, have been independently employed by \_\_\_\_\_ (hereinafter “the Client”) who intends to purchase a house and other improvements (the “Home”) on land to be leased from Community Land Trust. The house and land are located at \_\_\_\_\_.

In connection with the contemplated purchase of the Home and the leasing of the land, I reviewed with the Client the following documents:

- a) this Letter of Attorney’s Acknowledgment and a Letter of Agreement from the Client;
- b) a proposed Deed conveying the Home to the Client;
- c) a proposed Ground Lease conveying the “Leased Land” to the Client;
- d) other written materials provided by the CLT.

The Client has received full and complete information and advice regarding this conveyance and the foregoing documents. In my review of these documents my purpose has been to reasonably inform the Client of the present and foreseeable risks and legal consequences of the contemplated transaction.

The Client is entering the aforesaid transaction in reliance on her own judgment and upon her investigation of the facts. The advice and information provided by me was an integral element of such investigation.

Name

Date

Title

Firm/Address

**Exhibit DEED**

*Sample*  
**Deed**

**Between**

LOCAL LAND TRUST (Grantor), a not-for-profit corporation having its principal offices at \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_, and

JOHN AND MARY DOE (Grantees), residing at \_\_\_\_\_, \_\_\_\_\_, \_\_\_\_\_.

**Witnesseth**

That Grantor, in consideration of one dollar and other good and valuable consideration paid by Grantees, does hereby grant and release unto Grantees, their heirs, or successors and assigns forever,

THE BUILDINGS AND OTHER IMPROVEMENTS ONLY, as presently erected on the Land described in Schedule "A" attached hereto and made a part hereof.

It is the intention of the parties that the real property underlying the buildings and other improvements conveyed herein remain vested in Grantor and that this warranty deed convey only such buildings and other improvements as are presently erected upon the subject Land.

In witness whereof, as authorized agent of Grantor, I hereunto set my hand this \_\_\_\_ day of \_\_\_\_\_, A.D. 20\_\_.

\_\_\_\_\_  
signature

[notarize signature]

**Exhibit: PERMITTED MORTGAGES**

The rights and provisions set forth in this Exhibit shall be understood to be provisions of Section 8.2 of the of the Lease. All terminology used in this Exhibit shall have the meaning assigned to it in the Lease.

**A. OBLIGATIONS OF PERMITTED MORTGAGEE.** Any Permitted Mortgagee shall be bound by each of the following requirements unless the particular requirement is removed, contradicted or modified by a rider to this Lease signed by the Homeowner and the CLT to modify the terms of the Lease during the term of the Permitted Mortgage.

1. If Permitted Mortgagee sends a notice of default to the Homeowner because the Homeowner has failed to comply with the terms of the Permitted Mortgage, the Permitted Mortgagee shall, at the same time, send a copy of that notice to the CLT. Upon receiving a copy of the notice of default and within that period of time in which the Homeowner has a right to cure such default (the "cure period"), the CLT shall have the right to cure the default on the Homeowner's behalf, provided that all current payments due the Permitted Mortgagee since the notice of default was given are made to the Permitted Mortgagee.
2. If, after the cure period has expired, the Permitted Mortgagee intends to accelerate the note secured by the Permitted Mortgage or begin foreclosure proceedings under the Permitted Mortgage, the Permitted Mortgagee shall first notify CLT of its intention to do so, and CLT shall then have the right, upon notifying the Permitted Mortgagee within thirty (30) days of receipt of such notice, to acquire the Permitted Mortgage by paying off the debt secured by the Permitted Mortgage.
3. If the Permitted Mortgagee acquires title to the Home through foreclosure or acceptance of a deed in lieu of foreclosure, the Permitted Mortgagee shall give CLT written notice of such acquisition and CLT shall then have an option to purchase the Home from the Permitted Mortgagee for the full amount owing to the Permitted Mortgagee under the Permitted Mortgage. To exercise this option to purchase, CLT must give written notice to the Permitted Mortgagee of CLT's intent to purchase the Home within thirty (30) days following CLT's receipt of the Permitted Mortgagee's notice. CLT must then complete the purchase of the Home within sixty (60) days of having given written notice of its intent to purchase. If CLT does not complete the purchase within this 60-day period, the Permitted Mortgagee shall be free to sell the Home to another person.
4. Nothing in the Permitted Mortgage or related documents shall be construed as giving Permitted Mortgagee a claim on CLT's interest in the Leased Land, or as assigning any form of liability to the CLT with regard to the Leased Land, the Home, or the Permitted Mortgage.
5. Nothing in the Permitted Mortgage or related documents shall be construed as rendering CLT or any subsequent Mortgagee of CLT's interest in this Lease, or their respective heirs, executors, successors or assigns, personally liable for the payment of the debt secured by the Permitted Mortgage or any part thereof.
6. The Permitted Mortgagee shall not look to CLT or CLT's interest in the Leased Land, but will look solely to Homeowner, Homeowner's interest in the Leased Land, and the Home for the payment of the debt secured thereby or any part thereof. (It is the intention of the parties

hereto that CLT's consent to such the Permitted Mortgage shall be without any liability on the part of CLT for any deficiency judgment.)

7. In the event any part of the Security is taken in condemnation or by right of eminent domain, the proceeds of the award shall be paid over to the Permitted Mortgagee in accordance with the provisions of ARTICLE 9 hereof.

8. CLT shall not be obligated to execute an assignment of the Lease Fee or other rent payable by Homeowner under the terms of this Lease.

**B. RIGHTS OF PERMITTED MORTGAGEE.** The rights of a Permitted Mortgagee as referenced under Section 8.6 of the Lease to which this Exhibit is attached shall be as set forth below.

1. Any Permitted Mortgagee shall, without further consent by CLT, have the right to (a) cure any default under this Lease, and perform any obligation required under this Lease, such cure or performance being effective as if it had been performed by Homeowner; (b) acquire and convey, assign, transfer and exercise any right, remedy or privilege granted to Homeowner by this Lease or otherwise by law, subject to the provisions, if any, in the Permitted Mortgage, which may limit any exercise of any such right, remedy or privilege; and (c) rely upon and enforce any provisions of the Lease to the extent that such provisions are for the benefit of a Permitted Mortgagee.

2. A Permitted Mortgagee shall not be required, as a condition to the exercise of its rights under the Lease, to assume personal liability for the payment and performance of the obligations of the Homeowner under the Lease. Any such payment or performance or other act by Permitted Mortgagee under the Lease shall not be construed as an agreement by Permitted Mortgagee to assume such personal liability except to the extent Permitted Mortgagee actually takes possession of the Home and Leased Land. In the event Permitted Mortgagee does take possession of the Home and Leased Land and thereupon transfers such property, any such transferee shall be required to enter into a written agreement assuming such personal liability and upon any such assumption the Permitted Mortgagee shall automatically be released from personal liability under the Lease.

3. In the event that title to the estates of both CLT and Homeowner are acquired at any time by the same person or persons, no merger of these estates shall occur without the prior written declaration of merger by Permitted Mortgagee, so long as Permitted Mortgagee owns any interest in the Security or in a Permitted Mortgage.

4. If the Lease is terminated for any reason, or in the event of the rejection or disaffirmance of the Lease pursuant to bankruptcy law or other law affecting creditors' rights, CLT shall enter into a new lease for the Leased Land with the Permitted Mortgagee (or with any party designated by the Permitted Mortgagee, subject to CLT's approval, which approval shall not be unreasonably withheld), not more than thirty (30) days after the request of the Permitted Mortgagee. Such lease shall be for the remainder of the term of the Lease, effective as of the date of such termination, rejection or disaffirmance, and upon all the terms and provisions contained in the Lease. However, the Permitted Mortgagee shall make a written request to CLT for such new lease within sixty (60) days after the effective date of such termination,

rejection or disaffirmance, as the case may be. Such written request shall be accompanied by a copy of such new lease, duly executed and acknowledged by the Permitted Mortgagee or the party designated by the Permitted Mortgagee to be the Homeowner thereunder. Any new lease made pursuant to this Section shall have the same priority with respect to other interests in the Land as the Lease. The provisions of this Section shall survive the termination, rejection or disaffirmance of the Lease and shall continue in full effect thereafter to the same extent as if this Section were independent and an independent contract made by CLT, Homeowner and the Permitted Mortgagee.

5. The CLT shall have no right to terminate the Lease during such time as the Permitted Mortgagee has commenced foreclosure in accordance with the provisions of the Lease and is diligently pursuing the same.

6. In the event that CLT sends a notice of default under the Lease to Homeowner, CLT shall also send a notice of Homeowner’s default to Permitted Mortgagee. Such notice shall be given in the manner set forth in Section 14.2 of the Lease to the Permitted Mortgagee at the address which has been given by the Permitted Mortgagee to CLT by a written notice to CLT sent in the manner set forth in said Section 14.2 of the Lease.

7. In the event of foreclosure sale by a Permitted Mortgagee or the delivery of a deed to a Permitted Mortgagee in lieu of foreclosure in accordance with the provisions of the Lease, at the election of the Permitted Mortgagee the provisions of Article 10, Sections 10.1 through 10.11 shall be deleted and thereupon shall be of no further force or effect as to only so much of the Security so foreclosed upon or transferred.

8. Before becoming effective, any amendments to this Lease must be approved in writing by Permitted Mortgagee, which approval shall not be unreasonably withheld. If Permitted Mortgagee has neither approved nor rejected a proposed amendment within 60 days of its submission to Permitted Mortgagee, then the proposed amendment shall be deemed to be approved.

C. STANDARD PERMITTED MORTGAGE AGREEMENT. A Standard Permitted Mortgage Agreement, as identified in Section 8.4 of this Lease, shall be written as follows, and shall be signed by Mortgagee and Homeowner.

*This Agreement is made by and among:*

\_\_\_\_\_ (Mortgagee) and  
 \_\_\_\_\_ (“Homeowner”),

**Whereas:**

- a) \_\_\_\_\_ CLT (the “CLT”) and Homeowner have entered, or are entering, into a ground lease (“the Lease”), conveying to Homeowner a leasehold interest in the Land located at \_\_\_\_\_ (“the Leased Land”); and Homeowner has purchased, or is purchasing, the Home located on the Leased Land (“the Home”).
- b) The Mortgagee has been asked to provide certain financing to the Homeowner, and is being granted concurrently herewith a mortgage and security interest (the “Mortgage”) in the Leased Land and Home, all as more particularly set forth in the Mortgage, attached

*hereto as Schedule A.*

- c) *The Ground Lease states that the Homeowner may mortgage the Leased Land only with the written consent of CLT. The Ground Lease further provides that CLT is required to give such consent only if the Mortgagee signs this Standard Permitted Mortgage Agreement and thereby agrees to certain conditions that are stipulated herein (“the Stipulated Conditions”).*

*Now, therefore, the Homeowner/Mortgagor and the Mortgagee hereby agree that the terms and conditions of the Mortgage shall include the Stipulated Conditions stated below.*

***Stipulated Conditions:***

*1) If Mortgagee sends a notice of default to the Homeowner because the Homeowner has failed to comply with the terms of the Mortgage, the Mortgagee shall, at the same time, send a copy of that notice to the CLT. Upon receiving a copy of the notice of default and within that period of time in which the Homeowner has a right to cure such default (the “cure period”), the CLT shall have the right to cure the default on the Homeowner’s behalf, provided that all current payments due the Permitted Mortgagee since the notice of default was given are made to the Mortgagee.*

*2) If, after such cure period, the Mortgagee intends to accelerate the note secured by the Mortgage or initiate foreclosure proceedings under the Mortgage, in accordance with the provisions of the Lease, the Mortgagee shall first notify CLT of its intention to do so and CLT shall have the right, but not the obligation, upon notifying the Mortgagee within thirty (30) days of receipt of said notice, to purchase the Mortgagee loans and to take assignment of the Mortgage.*

*3) If the Mortgagee acquires title to the Home and Homeowner’s interest in the Leased Land through foreclosure or acceptance of a deed in lieu of foreclosure, the Mortgagee shall give the CLT written notice of such acquisition and the CLT shall have an option to purchase the Home and Homeowner’s interest in the Leased Land from the Mortgagee for the full amount owing to the Mortgagee; provided, however, that the CLT notifies the Mortgagee in writing of the CLT’s intent to make such purchase within thirty (30) days following the CLT’s receipt of the Mortgagee’s notice of such acquisition of the Home and Homeowner’s interest in the Leased Land; further provided that CLT shall complete such purchase within sixty (60) days of having given written notice of its intent to purchase; and provided that, if the CLT does not complete the purchase within such period, the Mortgagee shall be free to sell the Home and Homeowner’s interest in the Leased Land to another person;*

*4) Nothing in the Mortgage or related documents shall be construed as giving the Mortgagee a claim on CLT’s interest in the Leased Land, or as assigning any form of liability to the CLT with regard to the Leased Land, the Home, or the Mortgage.*

*5) Nothing in the Mortgage shall be construed as rendering CLT or any subsequent holder of the CLT’s interest in and to the Lease, or their respective heirs, executors, successors or assigns, personally liable for the payment of the debt evidenced by such note and such Mortgage or any part thereof.*

6) *The Mortgagee shall not look to CLT or CLT's interest in the Leased Land, but will look solely to Homeowner and Homeowner's interest in the Leased Land and the Home for the payment of the debt secured by the Mortgage. (It is the intention of the parties hereto that CLT's consent to the Mortgage shall be without any liability on the part of CLT for any deficiency judgment.)*

7) *In the event that any part of the Leased Land is taken in condemnation or by right of eminent domain, the proceeds of the award shall be paid over to the Mortgagee in accordance with the provisions of Article 9 of the Lease.*

8) *Nothing in the Mortgage shall obligate CLT to execute an assignment of the Lease Fee or other rent payable by Homeowner under the terms of this Lease.*

By:

\_\_\_\_\_ for Mortgagee                      Date: \_\_\_\_\_

\_\_\_\_\_ for Homeowner/Mortgagor      Date: \_\_\_\_\_

**Exhibit FIRST REFUSAL**

Whenever any party under the Lease shall have a right of first refusal as to certain property, the following procedures shall apply. If the owner of the property offering it for sale ("Offering Party") shall within the term of the Lease receive a bona fide third party offer to purchase the property which such Offering Party is willing to accept, the holder of the right of first refusal (the "Holder") shall have the following rights:

a) Offering Party shall give written notice of such offer ("the Notice of Offer") to Holder setting forth (a) the name and address of the prospective purchaser of the property, (b) the purchase price offered by the prospective purchaser and (c) all other terms and conditions of the sale. Holder shall have a period of forty-five (45) days after the receipt of the Notice of Offer ("the Election Period") within which to exercise the right of first refusal by giving notice of intent to purchase the property ("the Notice of Intent to Purchase") for the same price and on the same terms and conditions set forth in the Notice of Offer. Such Notice of Intent to Purchase shall be given in writing to the Offering Party within the Election Period.

b) If Holder exercises the right to purchase the property, such purchase shall be completed within sixty (60) days after the Notice of Intent to Purchase is given by Holder (or if the Notice of Offer shall specify a later date for closing, such date) by performance of the terms and conditions of the Notice of Offer, including payment of the purchase price provided therein.

c) Should Holder fail to exercise the right of first refusal within the Election Period, then the Offering Party shall have the right (subject to any other applicable restrictions in the Lease) to go forward with the sale which the Offering Party desires to accept, and to sell the property within one (1) year following the expiration of the Election Period on terms and conditions which are not materially more favorable to the purchaser than those set forth in the Notice. If the sale is not consummated within such one-year period, the Offering Party's right so to sell shall end, and all of the foregoing provisions of this section shall be applied again to any

future offer, all as aforesaid. If a sale is consummated within such one-year period, the purchaser shall purchase subject to the Holder having a renewed right of first refusal in said property.

### **Other Exhibits to be Attached as Appropriate**

Exhibit LAND [*Correct legal description of area of Leased Land and appurtenant title rights and obligations.*]

Exhibit ZONING [*Setting forth applicable zoning restrictions as of the commencement of the Lease*]

Exhibit RESTRICTIONS [*To be attached when necessary to stipulate use restrictions not included under Zoning*]

Exhibit INITIAL APPRAISAL [*To be attached if Lease contains an “appraisal-based” resale formula*]

## **APPENDIX: Four Versions of Article 10**

### **ARTICLE 10: Transfer of the Home**

#### **Article 10: Version 1**

*For situations in which:*

- a) the Homeowner has no absolute right to identify a buyer and can only recommend a buyer;*
- b) an “improvements-only appraisal-based formula” is used; and*
- c) the original base price is not greater than the original appraised value of the Home.*

10.1 INTENT OF THIS ARTICLE IS TO PRESERVE AFFORDABILITY: Homeowner and CLT agree that the provisions of this Article 10 are intended to preserve the affordability of the Home for lower income households and expand access to homeownership opportunities for such households.

10.2 HOMEOWNER MAY TRANSFER HOME ONLY TO CLT OR QUALIFIED PERSONS: Homeowner may transfer the Home only to the CLT or an Income-Qualified Person as defined below or otherwise only as explicitly permitted by the provisions of this Article 10. All such transfers are to be completed only in strict compliance with this Article 10. Any purported transfer that does not follow the procedures set forth below, except in the case of a transfer to a Permitted Mortgagee in lieu of foreclosure, shall be null and void.

“Income-Qualified Person” shall mean a person or group of persons whose household income does not exceed \_\_\_\_\_ percent (\_\_\_%) of the median household income for the applicable Standard Metropolitan Statistical Area or County as calculated and adjusted for

household size from time to time by the U.S. Department of Housing and Urban Development (HUD) or any successor.

10.3 THE HOME MAY BE TRANSFERRED TO CERTAIN HEIRS OF HOMEOWNER: If Homeowner dies (or if the last surviving co-owner of the Home dies), the executor or personal representative of Homeowner's estate shall notify CLT within ninety (90) days of the date of the death. Upon receiving such notice CLT shall consent to a transfer of the Home and Homeowner's rights to the Leased Land to one or more of the possible heirs of Homeowner listed below as "a," "b," or "c," provided that a Letter of Agreement and a Letter of Attorney's Acknowledgment (as described in Article 1 above) are submitted to CLT to be attached to the Lease when it is transferred to the heirs.

- a) the spouse of the Homeowner; or
- b) the child or children of the Homeowner; or
- c) member(s) of the Homeowner's household who have resided in the Home for at least one year immediately prior to Homeowner's death.

Any other heirs, legatees or devisees of Homeowner, in addition to submitting Letters of Agreement and Attorney's Acknowledgment as provided above, must demonstrate to CLT's satisfaction that they are Income-Qualified Persons as defined above. If they cannot demonstrate that they are Income-Qualified Persons, they shall not be entitled to possession of the Home but must transfer the Home in accordance with the provisions of this Article 10.

10.4 HOMEOWNER'S NOTICE OF INTENT TO SELL: In the event that Homeowner wishes to sell Homeowner's Property, Homeowner shall notify CLT in writing of such wish (the Intent-to-Sell Notice). This Notice shall include a statement as to whether Homeowner wishes to recommend a prospective buyer as of the date of the Notice.

10.5 AFTER RECEIVING NOTICE, CLT SHALL COMMISSION AN APPRAISAL: No later than ten (10) days after CLT's receipt of Homeowner's Intent-to-Sell Notice, CLT shall commission a market valuation of the Leased Land and the Home (The Appraisal) to be performed by a duly licensed appraiser who is acceptable to CLT and Homeowner. CLT shall pay the cost of such Appraisal. The Appraisal shall be conducted by analysis and comparison of comparable properties as though title to Leased Land and Home were held in fee simple absolute by a single party, disregarding all of the restrictions of this Lease on the use, occupancy and transfer of the property. The Appraisal shall state the values contributed by the Leased Land and by the Home (consisting of improvements only) as separate amounts. Copies of the Appraisal are to be provided to both CLT and Homeowner.

10.6 CLT HAS AN OPTION TO PURCHASE THE HOME. Upon receipt of an Intent-to-Sell Notice from Homeowner, CLT shall have the option to purchase the Home at the Purchase Option Price calculated as set forth below. The Purchase Option is designed to further the purpose of preserving the affordability of the Home for succeeding Income-Qualified Persons while taking fair account of the investment by the Homeowner.

If CLT elects to purchase the Home, CLT shall exercise the Purchase Option by notifying Homeowner, in writing, of such election (the Notice of Exercise of Option) within forty-five

(45) days of the receipt of the Appraisal, or the Option shall expire. Having given such notice, CLT may either proceed to purchase the Home directly or may assign the Purchase Option to an Income-Qualified Person.

The purchase (by CLT or CLT's assignee) must be completed within sixty (60) days of CLT's Notice of Exercise of Option, or Homeowner may sell the Home and Homeowner's rights to the Leased Land as provided in Section 10.7 below. The time permitted for the completion of the purchase may be extended by mutual agreement of CLT and Homeowner.

Homeowner may recommend to CLT a prospective buyer who is an Income-Qualified Person and is prepared to submit Letters of Agreement and Attorney's Acknowledgement indicating informed acceptance of the terms of this Lease. CLT shall make reasonable efforts to arrange for the assignment of the Purchase Option to such person, unless CLT determines that its charitable mission is better served by retaining the Home for another purpose or transferring the Home to another party.

**10.7 IF PURCHASE OPTION EXPIRES, HOMEOWNER MAY SELL ON CERTAIN TERMS:** If the Purchase Option has expired or if CLT has failed to complete the purchase within the sixty-day period allowed by Section 10.6 above, Homeowner may sell the Home to any Income-Qualified Person for not more than the then applicable Purchase Option Price. If Homeowner has made diligent efforts to sell the Home for at least six months after the expiration of the Purchase Option (or six months after the expiration of such sixty-day period) and the Home still has not been sold, Homeowner may then sell the Home, for a price no greater than the then applicable Purchase Option Price, to any party regardless of whether that party is an Income-Qualified Person.

**10.8 AFTER ONE YEAR CLT SHALL HAVE POWER OF ATTORNEY TO CONDUCT SALE:** If CLT does not exercise its option and complete the purchase of Homeowner's Property as described above, and if Homeowner (a) is not then residing in the Home and (b) continues to hold Homeowner's Property out for sale but is unable to locate a buyer and execute a binding purchase and sale agreement within one year of the date of the Intent to Sell Notice, Homeowner does hereby appoint CLT its attorney in fact to seek a buyer, negotiate a reasonable price that furthers the purposes of this Lease, sell the property, and pay to the Homeowner the proceeds of sale, minus CLT's costs of sale and any other sums owed CLT by Homeowner.

**10.9 PURCHASE OPTION PRICE EQUALS LESSER OF APPRAISED VALUE OR FORMULA PRICE:** In no event may the Home be sold for a price that exceeds the Purchase Option Price. The Purchase Option Price shall be the lesser of (a) the value of the Home (consisting of improvements only) as determined by the Appraisal commissioned and conducted as provided in 10.5 above or (b) the price calculated in accordance with the formula described below (the Formula Price).

**10.10 HOW THE FORMULA PRICE IS CALCULATED:** The Formula Price shall be equal to Homeowner's Base Price, as stated below, plus 25% of the increase in market value of the Home, if any, calculated in the way described below.

*Homeowner's Base Price:* The parties agree that the Homeowner's Base Price for Homeowner's Property as of the signing of this Lease is \$ \_\_\_\_\_.

*Initial Appraised Value:* The parties agree that the appraised value of the Home at the time of Homeowner's purchase (the Initial Appraised Value) is \$ \_\_\_\_\_, as documented by the appraiser's report attached to this Lease as Exhibit INITIAL APPRAISAL.

*Increase in Market Value:* The increase in market value of the Home equals the appraised value of the Home at time of sale, calculated according to Section 10.5 above, minus the Initial Appraised Value.

*Homeowner's share of Increase in Market Value:* Homeowner's share of the increase in the market value of the Home equals twenty-five percent (25%) of the increase in market value as calculated above.

*Summary of Formula Price:* The Formula Price equals Homeowner's Base Price plus Homeowner's Share of Increase in Market Value.

**10.11 QUALIFIED PURCHASER SHALL RECEIVE NEW LEASE:** The CLT shall issue a new lease to any person who purchases the Home in accordance with the terms of this Article 10. The terms of such lease shall be the same as those of new leases issued to homebuyers at that time for land not previously leased by the CLT.

**10.12 PURCHASER MAY BE CHARGED A TRANSFER FEE.** In the event that Homeowner sells the home to a party other than the CLT (whether directly to such party or as a result of CLT's assignment of its Purchase Option to such party), the price to be paid by such purchaser shall include in addition to the Purchase Option Price, at the discretion of the CLT, a transfer fee to compensate the CLT for carrying out its responsibilities with regard to the transaction. The amount of the transfer fee shall be no more than \_\_\_% of the Purchase Option Price.

**10.13 HOMEOWNER REQUIRED TO MAKE NECESSARY REPAIRS AT TRANSFER:** The Homeowner is required to make necessary repairs when she voluntarily transfers the Home as follows:

- a) The person purchasing the Home ("Buyer") shall, prior to purchasing the Home, hire at her sole expense a building inspector with a current Home Inspector license from the \_\_\_\_\_ [licensing agency] to assess the condition of the Home and prepare a written report of the condition ("Inspection Report"). The Homeowner shall cooperate fully with the inspection.
- b) The Buyer shall provide a copy of the Inspection Report to Buyer's lender (if any), the Homeowner, and the CLT within 10 days after receiving the Inspection Report.
- c) Homeowner shall repair specific reported defects or conditions necessary to bring the Home into full compliance with Sections 4.2 and 7.5 above prior to transferring the Home.
- d) Homeowner shall bear the full cost of the necessary repairs and replacements. However, upon Homeowner's written request, the CLT may allow the Homeowner to pay all or a portion of the repair costs after transfer, from Homeowner's proceeds of sale, if Homeowner cannot afford to pay such costs prior to the transfer. In such event, either (i) 150% of the unpaid estimated cost of repairs or (ii) 100% of the unpaid cost of completed repairs shall be withheld from Homeowner's proceeds of

sale in a CLT-approved escrow account. ***[Add the following sentence only if provision is made for a repair reserve:*** Also, upon Homeowner's written request, CLT may, at its discretion, agree to release funds from the Repair Reserve Fund to cover some or all of the cost of such repairs, provided that such use of the Reserve is in full compliance with Section 7.6 above.]

- e) Homeowner shall allow CLT, Buyer, and Buyer's building inspector and lender's representative to inspect the repairs prior to closing to determine that the repairs have been satisfactorily completed.
- f) Upon sale or other transfer, Homeowner shall either (i) transfer the Home with all originally purchased appliances or replacements in the Home in good working order or (ii) reduce the Purchase Option Price by the market value of any such appliances that are not left with the Home in good working order.

## **Article 10: Version 2**

*For situations in which:*

- a) *the Homeowner has a right to identify a qualified buyer;*
- b) *an "improvements-only appraisal-based formula" is used; and*
- c) *the original base price is not greater than the original appraised value of the Home.*

10.1 INTENT OF THIS ARTICLE IS TO PRESERVE AFFORDABILITY: Homeowner and CLT agree that the provisions of this Article 10 are intended to preserve the affordability of the Home for lower income households and expand access to homeownership opportunities for such households.

10.2 HOMEOWNER MAY TRANSFER HOME ONLY TO CLT OR QUALIFIED PERSONS: Homeowner may transfer the Home only to the CLT or an Income-Qualified Person as defined below or otherwise only as explicitly permitted by the provisions of this Article 10. All such transfers are to be completed only in strict compliance with this Article 10. Any purported transfer that does not follow the procedures set forth below, except in the case of a transfer to a Permitted Mortgagee in lieu of foreclosure, shall be null and void.

"Income-Qualified Person" shall mean a person or group of persons whose household income does not exceed \_\_\_\_\_ percent (\_\_\_\_%) of the median household income for the applicable Standard Metropolitan Statistical Area or County as calculated and adjusted for household size from time to time by the U.S. Department of Housing and Urban Development (HUD) or any successor.

10.3 THE HOME MAY BE TRANSFERRED TO CERTAIN HEIRS OF HOMEOWNER: If Homeowner dies (or if the last surviving co-owner of the Home dies), the executor or personal representative of Homeowner's estate shall notify CLT within ninety (90) days of the date of the death. Upon receiving such notice CLT shall consent to a transfer of the Home and Homeowner's rights to the Leased Land to one or more of the possible heirs of Homeowner listed below as "a," "b," or "c," provided that a Letter of Agreement and a Letter of Attorney's Acknowledgment (as described in Article 1 above) are submitted to CLT to be attached to the Lease when it is transferred to the heirs.

- a) the spouse of the Homeowner; or
- b) the child or children of the Homeowner; or
- c) member(s) of the Homeowner's household who have resided in the Home for at least one year immediately prior to Homeowner's death.

Any other heirs, legatees or devisees of Homeowner, in addition to submitting Letters of Agreement and Attorney's Acknowledgment as provided above, must demonstrate to CLT's satisfaction that they are Income-Qualified Persons as defined above. If they cannot demonstrate that they are Income-Qualified Persons, they shall not be entitled to possession of the Home but must transfer the Home in accordance with the provisions of this Article 10.

10.4 HOMEOWNER MUST GIVE NOTICE OF INTENT TO SELL: In the event that Homeowner wishes to sell the Home, Homeowner shall notify CLT, in writing, of such wish (the Intent-to-Sell Notice). *[Statement re. recommending prospective buyer omitted].*

10.5 AFTER RECEIVING NOTICE, CLT SHALL COMMISSION AN APPRAISAL: No later than ten (10) days after CLT's receipt of Homeowner's Intent-to-Sell Notice, CLT shall commission a market valuation of the Leased Land and the Home (The Appraisal) to be performed by a duly licensed appraiser who is acceptable to CLT and Homeowner. CLT shall pay the cost of such Appraisal. The Appraisal shall be conducted by analysis and comparison of comparable properties as though title to Leased Land and Home were held in fee simple absolute by a single party, disregarding all of the restrictions of this Lease on the use, occupancy and transfer of the property. The Appraisal shall state the values contributed by the Leased Land and by the Home (consisting of improvements only) as separate amounts. Copies of the Appraisal are to be provided to both CLT and Homeowner.

10.6 HOMEOWNER HAS A RIGHT TO DESIGNATE A QUALIFIED BUYER: Homeowner may, no later than ten days following receipt of the Appraisal, notify CLT in writing that Homeowner has identified a prospective buyer. If Homeowner has thus identified a prospective buyer, then, within thirty (30) days of receipt of the Appraisal, Homeowner shall furnish to CLT, or cause to be furnished to CLT, the following information and documents: (1) the number of people in the prospective buyer's household, (2) such documentation of household income as CLT's policies then require for confirmation of a buyer's income-eligibility, (3) Letters of Agreement and Attorney's Acknowledgement indicating informed acceptance of the terms of this Lease, in form and substance similar to the letters in Exhibit LETTERS OF AGREEMENT AND ATTORNEY'S ACKNOWLEDGEMENT attached hereto; and (4) a statement of the price and other proposed terms of sale.

No sale or other disposition shall be effective unless and until CLT, within thirty (30) days of receipt of all of the documents listed in the paragraph above, confirms in writing that the prospective buyer is an income-qualified person who understands and accepts the terms of the Lease and that the price and other terms of sale are consistent with the terms of the Lease. If CLT determines that the proposed buyer or proposed sale are not permitted under the terms of the Lease, then CLT shall respond with written notice to Homeowner of this determination. If

CLT fails to respond in writing within thirty (30) days of its receipt of the required documents, such failure shall be deemed to constitute approval of the sale.

Upon receipt of CLT's approval as described above, Homeowner may proceed to sell the Home to the prospective buyer. Simultaneously with the closing of such sale, CLT shall issue a new Lease as provided in Section 10.11 below). Homeowner shall complete such sale within sixty (60) days of receipt of approval of the proposed sale.

**10.7 CLT MAY EXERCISE PURCHASE OPTION IF HOMEOWNER DOES NOT SELL TO A QUALIFIED BUYER:** Upon receipt of an Intent to Sell Notice from Homeowner, CLT shall have the option to purchase said Home (the Purchase Option) at the Purchase Option Price calculated as set forth below, unless Homeowner has identified a prospective buyer and is proceeding to seek approval of such buyer and to sell to such buyer in accordance with the provisions of Section 10.6 above. The Purchase Option is designed to further the purpose of preserving the affordability of the Home for succeeding Income-Qualified Persons while taking fair account of the investment of labor and capital by the Homeowner. Homeowner and CLT agree to cooperate in furthering such purposes by facilitating the sale of the Home to an Income-Qualified Person. Such purposes are understood to be accomplished, without CLT having otherwise exercised the Purchase Option, if the Home is sold, in accordance with Section 10.6 above, to a buyer identified by Homeowner. CLT shall not exercise the purchase option directly during such time as Homeowner is proceeding to sell to a prospective buyer in accordance with Section 10.6.

The CLT may exercise the Purchase Option within a forty-five (45) day period beginning ten days after Homeowner's receipt of the Appraisal unless Homeowner has, during such ten-day period, given notice identifying a prospective buyer. If Homeowner has identified a prospective buyer but for any reason the sale to such prospective buyer cannot be completed, then CLT may exercise the Purchase Option within a forty-five (45) day period beginning at such time as it is established that sale to such prospective buyer cannot be completed. In either case, to exercise the Purchase Option, CLT shall, within the applicable forty-five-day period, notify Homeowner in writing of its election to purchase the Home ("Notice of Exercise of Purchase Option").

If CLT gives Notice of Exercise of Purchase Option to Homeowner, CLT shall then complete the purchase of the Home within sixty (60) days of the date on which it gives such notice. If CLT either fails to give such notice within the time permitted or fails to complete the purchase within the time permitted, Homeowner may sell the Home as provided in Section 10.8 below.

Purchase of the Home pursuant to the Purchase Option may be accomplished by CLT's giving Notice of Exercise of Purchase Option and thereupon assigning the Option to an Income-Qualified Person who then completes the purchase of the Home within sixty days of the date of the exercise of the purchase option. The time permitted for the completion of the purchase of the Home may be extended by mutual agreement of CLT and Homeowner.

**10.8 IF PURCHASE OPTION EXPIRES, HOMEOWNER MAY SELL ON CERTAIN TERMS:** If the Purchase Option has expired or if CLT has failed to complete the purchase

within the sixty-day period allowed by Section 10.7 above, Homeowner may sell the Home to any Income-Qualified Person for not more than the then applicable Purchase Option Price. If Homeowner has made diligent efforts to sell the Home for at least six months after the expiration of the Purchase Option (or six months after the expiration of such sixty-day period) and the Home still has not been sold, Homeowner may then sell the Home, for a price no greater than the then applicable Purchase Option Price, to any party regardless of whether that party is an Income-Qualified Person.

**10.9 AFTER ONE YEAR, CLT SHALL HAVE POWER OF ATTORNEY TO CONDUCT SALE:** If CLT does not exercise its option and complete the purchase of Homeowner's Property as described above, and if Homeowner (a) is not then residing in the Home and (b) continues to hold Homeowner's Property out for sale but is unable to locate a buyer and execute a binding purchase and sale agreement within one year of the date of the Intent to Sell Notice, Homeowner does hereby appoint CLT its attorney in fact to seek a buyer, negotiate a reasonable price that furthers the purposes of this Lease, sell the property, and pay to the Homeowner the proceeds of sale, minus CLT's costs of sale and any other sums owed CLT by Homeowner.

**10.10 PURCHASE OPTION PRICE EQUALS LESSER OF APPRAISED VALUE OR FORMULA PRICE:** In no event may the Home be sold for a price that exceeds the Purchase Option Price. The Purchase Option Price shall be the lesser of (a) the value of the Home (consisting of improvements only) as determined by the Appraisal commissioned and conducted as provided in 10.5 above or (b) the price calculated in accordance with the formula described below (the Formula Price).

**10.11 HOW THE FORMULA PRICE IS CALCULATED:** The Formula Price shall be equal to Homeowner's Base Price, as stated below, plus 25% of the increase in market value of the Home, if any, calculated in the way described below.

*Homeowner's Base Price:* The parties agree that the Homeowner's Base Price for Homeowner's Property as of the signing of this Lease is \$ \_\_\_\_\_.

*Initial Appraised Value:* The parties agree that the appraised value of the Home at the time of Homeowner's purchase (the Initial Appraised Value) is \$ \_\_\_\_\_, as documented by the appraiser's report attached to this Lease as Exhibit INITIAL APPRAISAL.

*Increase in Market Value:* The increase in market value of the Home equals the appraised value of the Home at time of sale, calculated according to Section 10.5 above, minus the Initial Appraised Value.

*Homeowner's share of Increase in Market Value:* Homeowner's share of the increase in the market value of the Home equals twenty-five percent (25%) of the increase in market value as calculated above.

*Summary of Formula Price:* The Formula Price equals Homeowner's Base Price plus Homeowner's Share of Increase in Market Value.

**10.12 QUALIFIED PURCHASER SHALL RECEIVE NEW LEASE:** The CLT shall issue a new lease to any person who purchases the Home in accordance with the terms of this Article

10. Such new Lease shall be substantially the same as this Lease in the rights, benefits and obligations assigned to Homeowner and CLT.

10.13 PURCHASER MAY BE CHARGED A TRANSFER FEE. In the event that Homeowner sells the home to a party other than the CLT (whether directly to such party or as a result of CLT's assignment of its Purchase Option to such party), the price to be paid by such purchaser shall include in addition to the Purchase Option Price, at the discretion of the CLT, a transfer fee to compensate the CLT for carrying out its responsibilities with regard to the transaction. The amount of the transfer fee shall be no more than \_\_\_% of the Purchase Option Price.

10.14 HOMEOWNER REQUIRED TO MAKE NECESSARY REPAIRS AT TRANSFER: The Homeowner is required to make necessary repairs when she voluntarily transfers the Home as follows:

- a) The person purchasing the Home ("Buyer") shall, prior to purchasing the Home, hire at her sole expense a building inspector with a current Home Inspector license from the \_\_\_\_\_ [licensing agency] to assess the condition of the Home and prepare a written report of the condition ("Inspection Report"). The Homeowner shall cooperate fully with the inspection.
- b) The Buyer shall provide a copy of the Inspection Report to Buyer's lender (if any), the Homeowner, and the CLT within 10 days after receiving the Inspection Report.
- c) Homeowner shall repair specific reported defects or conditions necessary to bring the Home into full compliance with Sections 4.2 and 7.5 above prior to transferring the Home.
- d) Homeowner shall bear the full cost of the necessary repairs and replacements. However, upon Homeowner's written request, the CLT may allow the Homeowner to pay all or a portion of the repair costs after transfer, from Homeowner's proceeds of sale, if Homeowner cannot afford to pay such costs prior to the transfer. In such event, either (i) 150% of the unpaid estimated cost of repairs or (ii) 100% of the unpaid cost of completed repairs shall be withheld from Homeowner's proceeds of sale in a CLT-approved escrow account. ***[Add the following sentence only if provision is made for a repair reserve:*** Also, upon Homeowner's written request, CLT may, at its discretion, agree to release funds from the Repair Reserve Fund to cover some or all of the cost of such repairs, provided that such use of the Reserve is in full compliance with Section 7.6 above.]
- e) Homeowner shall allow CLT, Buyer, and Buyer's building inspector and lender's representative to inspect the repairs prior to closing to determine that the repairs have been satisfactorily completed.
- f) Upon sale or other transfer, Homeowner shall either (i) transfer the Home with all originally purchased appliances or replacements in the Home in good working order or (ii) reduce the Purchase Option Price by the market value of any such appliances that are not left with the Home in good working order.

**Article 10: Version 3**

*For situations in which:*

- a) *the Homeowner has no absolute right to identify buyer and can only recommend buyer;*
- b) *a “compound appraisal-based formula” is used; and*
- c) *the original base price is greater than the original appraised value of the Home.*

10.1 INTENT OF THIS ARTICLE IS TO PRESERVE AFFORDABILITY: Homeowner and CLT agree that the provisions of this Article 10 are intended to preserve the affordability of the Home for lower income households and expand access to homeownership opportunities for such households.

10.2 HOMEOWNER MAY TRANSFER HOME ONLY TO CLT OR QUALIFIED PERSONS: Homeowner may transfer the Home only to the CLT or an Income-Qualified Person as defined below or otherwise only as explicitly permitted by the provisions of this Article 10. All such transfers are to be completed only in strict compliance with this Article 10. Any purported transfer that does not follow the procedures set forth below, except in the case of a transfer to a Permitted Mortgagee in lieu of foreclosure, shall be null and void.

“Income-Qualified Person” shall mean a person or group of persons whose household income does not exceed \_\_\_\_\_ percent (\_\_\_%) of the median household income for the applicable Standard Metropolitan Statistical Area or County as calculated and adjusted for household size from time to time by the U.S. Department of Housing and Urban Development (HUD) or any successor.

10.3 THE HOME MAY BE TRANSFERRED TO CERTAIN HEIRS OF HOMEOWNER: If Homeowner dies (or if the last surviving co-owner of the Home dies), the executor or personal representative of Homeowner’s estate shall notify CLT within ninety (90) days of the date of the death. Upon receiving such notice CLT shall consent to a transfer of the Home and Homeowner’s rights to the Leased Land to one or more of the possible heirs of Homeowner listed below as “a,” “b,” or “c,” provided that a Letter of Agreement and a Letter of Attorney’s Acknowledgment (as described in Article 1 above) are submitted to CLT to be attached to the Lease when it is transferred to the heirs.

- a) the spouse of the Homeowner; or
- b) the child or children of the Homeowner; or
- c) member(s) of the Homeowner’s household who have resided in the Home for at least one year immediately prior to Homeowner’s death.

Any other heirs, legatees or devisees of Homeowner, in addition to submitting Letters of Agreement and Attorney’s Acknowledgment as provided above, must demonstrate to CLT’s satisfaction that they are Income-Qualified Persons as defined above. If they cannot demonstrate that they are Income-Qualified Persons, they shall not be entitled to possession of the Home but must transfer the Home in accordance with the provisions of this Article.

10.4 HOMEOWNER MUST GIVE NOTICE OF INTENT TO SELL: In the event that Homeowner wishes to sell Homeowner’s Property, Homeowner shall notify CLT, in writing,

of such wish (the Intent-to-Sell Notice). This Notice shall include a statement as to whether Homeowner wishes to recommend a prospective buyer as of the date of the Notice.

10.5 AFTER RECEIVING NOTICE, CLT SHALL COMMISSION AN APPRAISAL: No later than ten (10) days after CLT's receipt of Homeowner's Intent-to-Sell Notice, CLT shall commission a market valuation of the Leased Land and the Home (The Appraisal) to be performed by a duly licensed appraiser who is acceptable to the Homeowner. CLT shall pay the cost of such Appraisal. The Appraisal shall be conducted by analysis and comparison of comparable properties as though title to Land and Home were held in fee simple absolute by a single party, disregarding all of the restrictions of this Lease on the use, occupancy and transfer of the property. Copies of the Appraisal are to be provided to both CLT and Homeowner. *[Statement re. separate appraised values for land and improvements omitted.]*

10.6 CLT HAS AN OPTION TO PURCHASE THE HOME. Upon receipt of an Intent-to-Sell Notice from Homeowner, CLT shall have the option to purchase the Home at the Purchase Option Price calculated as set forth below. The Purchase Option is designed to further the purpose of preserving the affordability of the Home for succeeding Income-Qualified Persons while taking fair account of the investment by the Homeowner.

If CLT elects to purchase the Home, CLT shall exercise the Purchase Option by notifying Homeowner, in writing, of such election (the Notice of Exercise of Option) within forty-five (45) days of the receipt of the Appraisal, or the Option shall expire. Having given such notice, CLT may either proceed to purchase the Home directly or may assign the Purchase Option to an Income-Qualified Person.

The purchase (by CLT or CLT's assignee) must be completed within sixty (60) days of CLT's Notice of Exercise of Option, or Homeowner may sell the Home and Homeowner's rights to the Leased Land as provided in Section 10.7 below. The time permitted for the completion of the purchase may be extended by mutual agreement of CLT and Homeowner.

Homeowner may recommend to CLT a prospective buyer who is an Income-Qualified Person and is prepared to submit Letters of Agreement and Attorney's Acknowledgement indicating informed acceptance of the terms of this Lease. CLT shall make reasonable efforts to arrange for the assignment of the Purchase Option to such person, unless CLT determines that its charitable mission is better served by retaining the Home for another purpose or transferring the Home to another party.

10.7 IF PURCHASE OPTION EXPIRES, HOMEOWNER MAY SELL ON CERTAIN TERMS: If the Purchase Option has expired or if CLT has failed to complete the purchase within the sixty-day period allowed by Section 10.6 above, Homeowner may sell the Home to any Income-Qualified Person for not more than the then applicable Purchase Option Price. If Homeowner has made diligent efforts to sell the Home for at least six months after the expiration of the Purchase Option (or six months after the expiration of such sixty-day period) and the Home still has not been sold, Homeowner may then sell the Home, for a price no greater than the then applicable Purchase Option Price, to any party regardless of whether that party is an Income-Qualified Person.

10.8 AFTER ONE YEAR CLT SHALL HAVE POWER OF ATTORNEY TO CONDUCT SALE: If CLT does not exercise its option and complete the purchase of Homeowner's Property as described above, and if Homeowner (a) is not then residing in the Home and (b) continues to hold Homeowner's Property out for sale but is unable to locate a buyer and execute a binding purchase and sale agreement within one year of the date of the Intent to Sell Notice, Homeowner does hereby appoint CLT its attorney in fact to seek a buyer, negotiate a reasonable price that furthers the purposes of this Lease, sell the property, and pay to the Homeowner the proceeds of sale, minus CLT's costs of sale and any other sums owed CLT by Homeowner.

10.9 PURCHASE OPTION PRICE EQUALS LESSER OF APPRAISED VALUE OF HOMEOWNER'S OWNERSHIP INTEREST OR FORMULA PRICE: In no event may the Home be sold for a price that exceeds the Purchase Option Price. The Purchase Option Price shall be the lesser of (a) the Appraised Value of Homeowner's Ownership Interest at Resale as calculated in line "d" of Section 10.10 below or (b) the Formula Price calculated in accordance with Section 10.10 below.

10.10 HOW THE FORMULA PRICE IS CALCULATED: The Formula Price shall be equal to (a) the amount of Homeowner's Base Price (as stated below), plus (b) 25% of any increase in the appraised value of Homeowner's Ownership Interest (as calculated below).

*Homeowner's Base Price:* The Parties agree that the price paid by Homeowner upon the execution of this lease (Homeowner's Base Price) is \$ \_\_\_\_\_. (Homeowner's Base Price equals Homeowner's Ownership Interest at time of purchase.)

*Initial Appraised Value of Home and Leased Land:* The parties agree that the total appraised value of Home and Leased Land at the time of Homeowner's purchase (the Initial Appraised Value) is \$ \_\_\_\_\_, as documented by the appraiser's report attached to this Lease as Exhibit INITIAL APPRAISAL,

*Ratio of Homeowner's Base Price to Initial Appraised Value.* The parties agree that the Ratio of Homeowner's Base Price to Initial Appraised Value, expressed as a percentage, is \_\_\_\_%.

*Appraised Value of Homeowner's Ownership Interest at Resale.* The appraised value of Homeowner's Ownership Interest at time of resale equals the appraised value of Home and Leased Land at resale, determined in accordance with Section 10.5, multiplied by the Ratio of Homeowner's Base Price to Initial Appraised Value (\_\_\_\_%) as calculated in line "c" above.

*Increase in Appraised Value of Homeowner's Ownership Interest:* The increase in appraised value of Homeowner's Ownership Interest equals the appraised value of Homeowner's Ownership Interest at resale determined in accordance with paragraph "d" above minus the Homeowner's Base Price stated in line "a" above.

*Homeowner's share of Increase in Appraised Value of Homeowner's Ownership Interest:* Homeowner's share of the increase in the appraised value of the Homeowner's Ownership Interest equals twenty-five percent (25%) of the increase in the appraised value of Homeowner's Ownership Interest as calculated in line "e" above.

*Formula Price:* The Formula Price equals Homeowner's Base Price (line "a") plus Homeowner's share of Increase in the appraised value of the Homeowner's Ownership Interest (line "f")

10.11 QUALIFIED PURCHASER SHALL RECEIVE NEW LEASE: The CLT shall issue a new lease to any person who purchases the Home in accordance with the terms of this Article 10. The terms of such lease shall be the same as those of new leases issued to homebuyers at that time for land not previously leased by the CLT.

10.12 PURCHASER MAY BE CHARGED A TRANSFER FEE. In the event that Homeowner sells the home to a party other than the CLT (whether directly to such party or as a result of CLT's assignment of its Purchase Option to such party), the price to be paid by such purchaser shall include in addition to the Purchase Option Price, at the discretion of the CLT, a transfer fee to compensate the CLT for carrying out its responsibilities with regard to the transaction. The amount of the transfer fee shall be no more than \_\_\_% of the Purchase Option Price.

10.13 HOMEOWNER REQUIRED TO MAKE NECESSARY REPAIRS AT TRANSFER: The Homeowner is required to make necessary repairs when she voluntarily transfers the Home as follows:

- a) The person purchasing the Home ("Buyer") shall, prior to purchasing the Home, hire at her sole expense a building inspector with a current Home Inspector license from the \_\_\_\_\_ [licensing agency] to assess the condition of the Home and prepare a written report of the condition ("Inspection Report"). The Homeowner shall cooperate fully with the inspection.
- b) The Buyer shall provide a copy of the Inspection Report to Buyer's lender (if any), the Homeowner, and the CLT within 10 days after receiving the Inspection Report.
- c) Homeowner shall repair specific reported defects or conditions necessary to bring the Home into full compliance with Sections 4.2 and 7.5 above prior to transferring the Home.
- d) Homeowner shall bear the full cost of the necessary repairs and replacements. However, upon Homeowner's written request, the CLT may allow the Homeowner to pay all or a portion of the repair costs after transfer, from Homeowner's proceeds of sale, if Homeowner cannot afford to pay such costs prior to the transfer. In such event, either (i) 150% of the unpaid estimated cost of repairs or (ii) 100% of the unpaid cost of completed repairs shall be withheld from Homeowner's proceeds of sale in a CLT-approved escrow account. ***[Add the following sentence only if provision is made for a repair reserve:*** Also, upon Homeowner's written request, CLT may, at its discretion, agree to release funds from the Repair Reserve Fund to cover some or all of the cost of such repairs, provided that such use of the Reserve is in full compliance with Section 7.6 above.]
- e) Homeowner shall allow CLT, Buyer, and Buyer's building inspector and lender's representative to inspect the repairs prior to closing to determine that the repairs have been satisfactorily completed.
- f) Upon sale or other transfer, Homeowner shall either (i) transfer the Home with all originally purchased appliances or replacements in the Home in good working order or

(ii) reduce the Purchase Option Price by the market value of any such appliances that are not left with the Home in good working order.

**Article 10: Version 4**

*For situations in which:*

- a) *the Homeowner has no absolute right to identify buyer and can only recommend buyer;*
- b) *a “fixed-rate” or “indexed” formula is used; and*
- c) *the original base price is greater than the original appraised value of the Home.*

*Three versions of section 10.10 are presented for three different “indexed formulas.”*

10.1 INTENT OF THIS ARTICLE IS TO PRESERVE AFFORDABILITY: Homeowner and CLT agree that the provisions of this Article 10 are intended to preserve the affordability of the Home for lower income households and expand access to homeownership opportunities for such households.

10.2 HOMEOWNER MAY TRANSFER HOME ONLY TO CLT OR QUALIFIED PERSONS: Homeowner may transfer the Home only to the CLT or an Income-Qualified Person as defined below or otherwise only as explicitly permitted by the provisions of this Article 10. All such transfers are to be completed only in strict compliance with this Article 10. Any purported transfer that does not follow the procedures set forth below, except in the case of a transfer to a Permitted Mortgagee in lieu of foreclosure, shall be null and void.

“Income-Qualified Person” shall mean a person or group of persons whose household income does not exceed \_\_\_\_\_ percent (\_\_\_%) of the median household income for the applicable Standard Metropolitan Statistical Area or County as calculated and adjusted for household size from time to time by the U.S. Department of Housing and Urban Development (HUD) or any successor.

10.3 THE HOME MAY BE TRANSFERRED TO CERTAIN HEIRS OF HOMEOWNER: If Homeowner dies (or if the last surviving co-owner of the Home dies), the executor or personal representative of Homeowner’s estate shall notify CLT within ninety (90) days of the date of the death. Upon receiving such notice CLT shall consent to a transfer of the Home and Homeowner’s rights to the Leased Land to one or more of the possible heirs of Homeowner listed below as “a,” “b,” or “c,” provided that a Letter of Agreement and a Letter of Attorney’s Acknowledgment (as described in Article 1 above) are submitted to CLT to be attached to the Lease when it is transferred to the heirs.

- a) the spouse of the Homeowner; or
- b) the child or children of the Homeowner; or
- c) member(s) of the Homeowner’s household who have resided in the Home for at least one year immediately prior to Homeowner’s death.

Any other heirs, legatees or devisees of Homeowner, in addition to submitting Letters of Agreement and Attorney’s Acknowledgment as provided above, must demonstrate to CLT’s satisfaction that they are Income-Qualified Persons as defined above. If they cannot

demonstrate that they are Income-Qualified Persons, they shall not be entitled to possession of the Home but must transfer the Home in accordance with the provisions of this Article.

10.4 HOMEOWNER MUST GIVE NOTICE OF INTENT TO SELL: In the event that Homeowner wishes to sell Homeowner's Property, Homeowner shall notify CLT, in writing, of such wish (the Intent-to-Sell Notice). This Notice shall include a statement as to whether Homeowner wishes to recommend a prospective buyer as of the date of the Notice.

*[Provision for required appraisal omitted.]*

10.5 UPON RECEIVING NOTICE, CLT HAS AN OPTION TO PURCHASE THE HOME. Upon receipt of an Intent-to-Sell Notice from Homeowner, CLT shall have the option to purchase the Home at the Purchase Option Price calculated as set forth below. The Purchase Option is designed to further the purpose of preserving the affordability of the Home for succeeding Income-Qualified Persons while taking fair account of the investment by the Homeowner.

If CLT elects to purchase the Home, CLT shall exercise the Purchase Option by notifying Homeowner, in writing, of such election (the Notice of Exercise of Option) within forty-five (45) days of the receipt of the Intent-to-Sell Notice, or the Option shall expire. Having given such notice, CLT may either proceed to purchase the Home directly or may assign the Purchase Option to an Income-Qualified Person.

The purchase (by CLT or CLT's assignee) must be completed within sixty (60) days of CLT's Notice of Exercise of Option, or Homeowner may sell the Home and Homeowner's rights to the Leased Land as provided in Section 10.7 below. The time permitted for the completion of the purchase may be extended by mutual agreement of CLT and Homeowner.

Homeowner may recommend to CLT a prospective buyer who is an Income-Qualified Person and is prepared to submit Letters of Agreement and Attorney's Acknowledgement indicating informed acceptance of the terms of this Lease. CLT shall make reasonable efforts to arrange for the assignment of the Purchase Option to such person, unless CLT determines that its charitable mission is better served by retaining the Home for another purpose or transferring the Home to another party.

10.6 IF PURCHASE OPTION EXPIRES, HOMEOWNER MAY SELL ON CERTAIN TERMS: If the Purchase Option has expired or if CLT has failed to complete the purchase within the sixty-day period allowed by Section 10.5 above, Homeowner may sell the Home to any Income-Qualified Person for not more than the then applicable Purchase Option Price. If Homeowner has made diligent efforts to sell the Home for at least six months after the expiration of the Purchase Option (or six months after the expiration of such sixty-day period) and the Home still has not been sold, Homeowner may then sell the Home, for a price no greater than the then applicable Purchase Option Price, to any party regardless of whether that party is an Income-Qualified Person.

10.7 AFTER ONE YEAR CLT SHALL HAVE POWER OF ATTORNEY TO CONDUCT SALE: If CLT does not exercise its option and complete the purchase of Homeowner's Property as described above, and if Homeowner (a) is not then residing in the Home and (b)

continues to hold Homeowner's Property out for sale but is unable to locate a buyer and execute a binding purchase and sale agreement within one year of the date of the Intent to Sell Notice, Homeowner does hereby appoint CLT its attorney in fact to seek a buyer, negotiate a reasonable price that furthers the purposes of this Lease, sell the property, and pay to the Homeowner the proceeds of sale, minus CLT's costs of sale and any other sums owed CLT by Homeowner.

**10.8 PURCHASE OPTION PRICE EQUALS LESSER OF APPRAISED VALUE OF HOMEOWNER'S OWNERSHIP INTEREST OR FORMULA PRICE:** In no event may the Home be sold for a price that exceeds the Purchase Option Price. The Purchase Option Price shall be the lesser of (a) the Appraised Value of Homeowner's Ownership Interest at Resale calculated in accordance with Section 10.9 below or (b) the Formula Price calculated in accordance with Section 10.10 below. If CLT does not choose to commission an appraisal to determine the appraised value of Homeowner's Ownership Interest, then the Purchase Option Price shall be the Formula Price.

**10.9 HOW THE VALUE OF HOMEOWNER'S OWNERSHIP INTEREST IS DETERMINED:** If CLT believes that the value of Homeowner's Ownership Interest at Resale may be less than the Formula Price, CLT may, within \_\_ days of receiving Homeowner's Notice of Intent to Sell, commission a market valuation of the Leased Land and the Home to be performed by a duly licensed appraiser acceptable to CLT and Homeowner. CLT shall pay the cost of such Appraisal. The Appraisal shall be conducted by analysis and comparison of comparable properties as though title to Land and Home were held in fee simple absolute by a single party, disregarding all of the restrictions of this Lease on the use, occupancy and transfer of the property. Copies of the Appraisal are to be provided to both CLT and Homeowner.

CLT and Homeowner agree that, at the time when Homeowner purchased the Home and executed the Lease with the CLT, the appraised market value of the Home and Leased Land was \$\_\_\_\_\_ (the "Initial Value), as documented by the appraiser's report attached to this Lease as Exhibit INITIAL APPRAISAL. CLT and Homeowner further agree that Homeowner's Base Price was \$ \_\_\_\_\_, and that this amount equals \_\_\_% of the Initial Value (the Ratio of Base Price to Initial Value)

The Value of Homeowner's Ownership Interest at Resale then equals the appraised value of the Home and Leased Land at resale multiplied by the Ratio of Base Price to Initial Value.

***[Three versions of 10.10 are presented below – one for a CPI-based formula, one for an AMI-based formula and one for a fixed-rate formula.]***

**10.10 [CPI Formula] HOW THE FORMULA PRICE IS CALCULATED:** The Formula Price shall be equal to (a) the amount of Homeowner's Base Price (which CLT and Homeowner agree is \$\_\_\_\_\_ ) plus (b) an amount equal to the Homeowner's Base Price multiplied by the total percentage of increase, since the date this Lease was signed, in the Consumer Price Index, as determined and published by the US Department of Labor or such successor agency as may publish such index, for urban wage earners and clerical workers for the urban area in which the Home is located, or, if none, for urban areas the size of

\_\_\_\_\_. The parties agree that when the Lease was signed the Consumer Price Index number (the Original Number) was \_\_\_\_\_. To determine the percentage of increase in the Index, the Original Number shall be subtracted from the most recently published Index number, and the remainder shall then be divided by the Original Number.

**OR**

10.10 **[AMI Formula]** HOW THE FORMULA PRICE IS CALCULATED: The Formula Price shall be equal to (a) the amount of Homeowner's Base Price (which CLT and Homeowner agree is \$\_\_\_\_\_) plus (b) an amount equal to the Homeowner's Base Price multiplied by the total percentage of increase, since the date this Lease was signed, in the area median household income (AMI) for a family of four for the \_\_\_\_\_ Standard Metropolitan Statistical Area [or \_\_\_\_\_ county], as calculated and published by the US Department of Housing and Urban Development or such successor agency as may publish such information. The parties agree that when the Lease was signed the MHI for a family of four in such area [or county] (the Original MHI) was \_\_\_\_\_. To determine the percentage of increase in the MHI, the Original MHI shall be subtracted from the then most recently published MHI, and the remainder shall then be divided by the Original MHI.

**OR**

10.10 **[Fixed-Rate Formula]** HOW THE FORMULA PRICE IS CALCULATED: The Formula Price shall be equal to the amount of Homeowner's Base Price (which CLT and Homeowner agree is \$\_\_\_\_\_) plus interest at a rate of \_\_\_% compounded annually.

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10.11 **QUALIFIED PURCHASER SHALL RECEIVE NEW LEASE:** The CLT shall issue a new lease to any person who purchases the Home in accordance with the terms of this Article 10. The terms of such lease shall be the same as those of new leases issued to homebuyers at that time for land not previously leased by the CLT.

10.12 **PURCHASER MAY BE CHARGED A TRANSFER FEE.** In the event that Homeowner sells the home to a party other than the CLT (whether directly to such party or as a result of CLT's assignment of its Purchase Option to such party), the price to be paid by such purchaser shall include in addition to the Purchase Option Price, at the discretion of the CLT, a transfer fee to compensate the CLT for carrying out its responsibilities with regard to the transaction. The amount of the transfer fee shall be no more than \_\_\_% of the Purchase Option Price.

**10.13 HOMEOWNER REQUIRED TO MAKE NECESSARY REPAIRS AT**

**TRANSFER:** The Homeowner is required to make necessary repairs when she voluntarily transfers the Home as follows:

- a) The person purchasing the Home ("Buyer") shall, prior to purchasing the Home, hire at her sole expense a building inspector with a current Home Inspector license from the \_\_\_\_\_ [licensing agency] to assess the condition of the Home and prepare a written report of the condition ("Inspection Report"). The Homeowner shall cooperate fully with the inspection.
- b) The Buyer shall provide a copy of the Inspection Report to Buyer's lender (if any), the Homeowner, and the CLT within 10 days after receiving the Inspection Report.

- c) Homeowner shall repair specific reported defects or conditions necessary to bring the Home into full compliance with Sections 4.2 and 7.5 above prior to transferring the Home.
- d) Homeowner shall bear the full cost of the necessary repairs and replacements. However, upon Homeowner's written request, the CLT may allow the Homeowner to pay all or a portion of the repair costs after transfer, from Homeowner's proceeds of sale, if Homeowner cannot afford to pay such costs prior to the transfer. In such event, either (i) 150% of the unpaid estimated cost of repairs or (ii) 100% of the unpaid cost of completed repairs shall be withheld from Homeowner's proceeds of sale in a CLT-approved escrow account. ***[Add the following sentence only if provision is made for a repair reserve:*** Also, upon Homeowner's written request, CLT may, at its discretion, agree to release funds from the Repair Reserve Fund to cover some or all of the cost of such repairs, provided that such use of the Reserve is in full compliance with Section 7.6 above.]
- e) Homeowner shall allow CLT, Buyer, and Buyer's building inspector and lender's representative to inspect the repairs prior to closing to determine that the repairs have been satisfactorily completed.
- f) Upon sale or other transfer, Homeowner shall either (i) transfer the Home with all originally purchased appliances or replacements in the Home in good working order or (ii) reduce the Purchase Option Price by the market value of any such appliances that are not left with the Home in good working order.

## **Chapter 11-B**

### **Commentary on the 2011 CLT Network Model Ground Lease**

This chapter comments on the terms of the Model Lease. The commentary is designed to provide information about the considerations that have gone into drafting and revising the Model Lease over the years – and in some cases the considerations that have gone into common variations of the model adopted by some CLTs – so that each new CLT can decide what particular provisions are most appropriate for its own situation. The commentary also touches upon certain legal issues that may deserve research under the laws of the particular jurisdiction in which the CLT will operate.

Headings in this commentary refer to specific articles or sections of the Model Lease. The section headings in the current version of the Model have been expanded (beyond those appearing in earlier versions) in order to give readers a more immediate sense of the gist of the section. In the commentary, more concise headings are used. It should be noted that section 14.9 states explicitly that all headings are for convenience only and “do not in any way limit or amplify the terms or conditions of this Lease.”

#### **Recitals**

The recitals, or introductory “whereas clauses,” set out background information about the parties to the transaction and their motivations. The clauses in the Model Lease probably apply to the majority of CLTs, but can and should be modified or supplemented to better fit the goals and purposes of a particular CLT.

There are several important legal effects of these clauses to bear in mind. If there is ever a dispute over the legal validity of some other section of the Lease, the understanding of the parties at the time of the original transaction, including the Homeowner’s willingness to give up certain typical rights of real estate ownership in return for the benefits provided by the CLT, may play a significant role in a court’s analysis. This section tries to make explicit the trade-offs that the prospective Homeowner was willing to accept and thereby emphasize that she entered the transaction voluntarily.

It is therefore important to have the “whereas clauses” accurately describe the goals and purposes involved. Because this Model Lease is designed for residential use, affordable housing goals are emphasized, but, if non-residential uses of the property are provided for or permitted in a CLT Lease, there may be a need to include references to such purposes as provision of social services, economic development, or environmental protection, among other possibilities.

All statements of the CLT’s purposes, including those that make reference to specific income levels, should be consistent with the CLT’s corporate purposes as stated in the Articles of Incorporation and as represented to the IRS in applying for recognition of tax-exempt status (see Chapters 4 and 6). In the Model, the references to the purposes of the CLT are framed with reference to “low and moderate income households.” Some CLTs may need to modify this language.

The Model Lease is drafted on the assumption that the parties are the CLT and an individual or family homeowner of a single family house on the Leased Land. There are, of course, other variations that could occur. A CLT may lease land, for a variety of purposes, to other nonprofit corporations, housing co-ops, condominium associations, mobile home park

associations, or private businesses, among other possibilities. (See Chapter 15, “CLTs and Limited Equity Housing Coops,” and Chapter 16, “Other Ground Leases.”)

It should also be noted, in the case of single-family residential properties, that more than one homeowner on a single tract of land. Care must be taken to clearly modify the identification of the parties and the introductory language to conform to the actual parties involved.

## Definitions

The terms defined here are key to a clear understanding of the most important relationships, rights and responsibilities established by the Lease. If you use these terms differently in your lease, the definitions should be adjusted accordingly. If you replace these terms with others you should of course define the others in this section. You may also want to add definitions of terms that are key to the particular resale formula that you decide to use (see commentary on Article 10).

It should be noted that in this 2011 version of the Model Lease several very basic terms are different from those used in earlier versions:

- The term *Homeowner* has replaced the term *Lessee*.
- The term *CLT* has replaced the term *Lessor*.
- The term *Home* has replaced the term *Improvements*.
- The term *Leased Land* has replace the term *Premises*, or *Leased Premises*.

## ARTICLE 1: Letters of Agreement and Attorney’s Acknowledgment

The Homeowner’s Letter of Agreement and the Attorney’s Letter of Acknowledgment (in previous versions identified as “Letter of Stipulation and Letter of Acknowledgment”) are designed to provide further evidence that the Homeowner understands the transaction and enters into it willingly. Although a sample Letter of Agreement is attached, this letter could be written by the prospective Homeowner in her own words, describing her individual situation and motivations in purchasing a resale-restricted CLT home, both personally and in terms of the larger CLT goals. This letter should not just be another document in small print signed at the closing. Of course, it is not always practical to ask the Homeowner to produce such a letter. The CLT probably will need to prepare something like the sample, which could be modified to fit individual circumstances.

The Attorney’s Letter of Acknowledgment indicates that the Homeowner had the benefit of legal counsel and that counsel explained the documents being signed. Any real estate transaction is complicated, particularly one involving limitations on the potential profit from resale. Counsel is not being asked to give any opinion on the adequacy of the legal documents or the fairness of the transaction. Counsel is only being asked to acknowledge that the documents were so reviewed.

It should be noted that there are some states where attorneys are not normally involved in closing real estate transactions. The appropriateness of an Attorney’s Letter of Acknowledgment has sometimes been questioned in these states, but in most cases CLTs have proceeded on the assumption that it is still important that the documents be explained to the Homeowner by a qualified, impartial third party, and that it is appropriate for attorneys to play this role. The sample Attorney’s Letter of Acknowledgment attached to this Revised Model Lease can be adapted to suit the circumstances of the particular situation.

## **ARTICLE 2: Leasing of Rights to the Land**

### **Section 2.1 CLT Leases Land to Homeowner**

Exhibit LEASED LAND is a legal description of the property being leased. Care should be taken to include as appurtenant to the Leased Land the right to use any easements or other benefits serving the Leased Land. Rights to use utilities and other physical matters serving the buildings on the Leased Land should also be included, as well as rights of access to repair and maintain such utilities. If the situation is such that certain portions of the land or certain facilities are shared by multiple owners – for instance shared utility or septic systems, shared driveways or parking areas – the circumstances will need to be addressed both in the description of the Leased Land and in other provisions of the Lease.

This section also states that the Leased Land is leased “as is,” so that the CLT is making no representations as to the quality of title to the Leased Land. The risk of a title problem is of concern to both the CLT and the Homeowner, and the Homeowner’s lender is likely to require a title certification or title search running in favor of the lender in the event of a loss due to a title problem. This is a cost typically borne by the buyer of property, and similarly the risk (and therefore by implication the cost of investigation), has been allocated to the Homeowner here. The parties could, of course, change this allocation.

### **Section 2.2 Reservation of Mineral Rights**

This reservation of mineral rights is probably relevant only to rural situations. Where mineral or other subsurface rights might be of particular value, this section could be altered or expanded. For example, rather than prohibiting the CLT from removing minerals from the leased Land without the Homeowner’s permission, the CLT might be allowed to proceed with removal without permission if its actions do not disrupt the Homeowners use of the property or if it takes certain steps to minimize the disruption and/or compensate the Homeowner.

In any case where the CLT does not in fact own the mineral rights, this section must of course be revised to accord with the facts.

In addition to mineral rights, there may be other types of property rights that need to be clarified in a particular area. For example, if some of the Leased Land is wooded, are the timber rights being leased to the Homeowner or are they being reserved to the CLT? If there is farmland, are there standards for farming practices that are important to the CLT? Any reservation of rights to the CLT or regulation of the Homeowner’s activities should be spelled out as clearly as possible to avoid conflicts and confusion in the future.

## **ARTICLE 3: Term of Lease; Change of Land Owner**

### **Sections 3.1 and 3.2 Principal Term and Homeowner’s Option to Extend**

The Model Lease uses a 99-year lease term because this is typically the longest lease term allowable before there is a question of whether the Homeowner’s property interest is really in the nature of fee simple ownership. As a general rule, the longer the leasehold term the more closely the Homeowner’s property rights resemble those of a full fee simple owner of the Land and Home. Also, as noted in Chapter 20, “Financing CLT Homes,” the longer leasehold term minimizes lenders’ concerns regarding the potential impact of the end of the lease term on their security.

The Homeowner’s option to renew the Lease extends the potential duration of the Homeowner’s security of tenure even further. The potential disadvantage of such provisions for the CLT is that the Land can be tied to a particular use for a very long time (though CLTs

will normally have the opportunity to exercise the purchase option and issue new leases, perhaps with modified provisions, when homes are resold). Community needs and goals may change during the term of a lease. A shorter lease term without a renewal option would give the CLT, as representative of community interest, a more certain opportunity to review whether the use permitted under the Lease still meets the needs of that community. In balancing these individual-versus-community interests, most CLTs have opted for a 99-year initial term, and most have followed the Model Lease in providing for renewal of such a term.

In most jurisdictions, a 99-year lease term is allowable. However, in some states, such as California, the option to renew at the end of a 99-year term is a remote interest in property which is invalid by statute or by common law application of the Rule Against Perpetuities (see discussion of Rule Against Perpetuities regarding Section 14.4 below; see also Chapter 9, “Enforceability of the CLT’s Preemptive Right”). In some cases the rule can be satisfied technically, for instance by making the renewal automatic. If in a particular state there is no way around this problem, then the choice is either to shorten the lease term to a legally acceptable length or not to provide a renewal option and leave the question of renewal to the decision of the parties at the end of the 99-year initial term.

A lease without a renewal option leaves the Homeowner in a weakened bargaining position at the end of the lease term. In that case, under current law, the CLT would be under no legal obligation to renew the Lease, except possibly an obligation to bargain in good faith. If the CLT or a successor were ever tempted to change course and use its land for other purposes, it could refuse to renew the Lease except on terms more favorable to it. On the other hand, after 99 years some of the terms of the Lease might no longer make much sense or might be unduly disadvantageous to the CLT, so there might be legitimate reasons to refuse a renewal on the same terms. In Section 3.2 a middle ground has been chosen, providing for a full 99-year term with an option to renew, but giving the CLT some flexibility to modify terms upon renewal so long as the modifications are not “materially adverse” to the Homeowner’s rights. The concept of “materially adverse” is admittedly open to interpretation, but is intended to distinguish changes which would cause some significant hardship to the Homeowner (e.g. a substantial increase in the Lease Fee) from generally benign changes (e.g. a new method of notice).

Note that the CLT is required to give written notice to Homeowner, 180 to 365 days prior to expiration, regarding the impending expiration of the Lease term. A Homeowner wishing to renew the Lease must then, within 60 days, give written notice to CLT, exercising the option to extend. The requirement that CLT give notice regarding impending expiration is intended to protect the Homeowner (by this time an heir of the original Homeowner) who may have no clear knowledge of when the Lease expires or of exactly what must be done to extend it.

### **Section 3.3 Change of Land Owner**

By giving the Homeowner a right of first refusal in the event of a sale of the Land to other than a public agency or nonprofit organization carrying out the CLT’s goals, the Model Lease provides an extra measure of security to the Homeowner. Some CLTs might choose to go a step further and give the Homeowner a right to buy for a limited (designed to be affordable) price in such a situation.

Note that the attachment “Exhibit FIRST REFUSAL” establishes specific terms for both the right of first refusal described in this section and the separate right of first refusal granted

to the CLT in Section 14.5. The Exhibit gives the holder of the right 45 days in which to notify the seller of her intent to purchase. The holder then has 60 days in which to complete the purchase. For CLT's seeking to facilitate FHA mortgage insurance for their homebuyers, it should be noted that FHA regulations limit the period in which such a right can be exercised to 45 days. At least as the language is understood by FHA, the right is "exercised" when the holder gives notice of intent to purchase.

## **ARTICLE 4: Use of Leased Land**

### **Section 4.1 Residential Use Only**

As drafted, the Model Lease assumes that the CLT will want to limit use of the Leased Land primarily to residential uses. Also allowed are uses that the local zoning code would permit as "incidental" to residential use. Such incidental uses are typically home occupations, such as haircutting, professional offices with minimal or no staff, and the like. Finally, if the CLT wishes to impose any restrictions on use that are not currently compelled by law, it can add them in an Exhibit RESTRICTIONS. A CLT can modify the terms of such an Exhibit from one leasehold to another, depending on the circumstances of the different sites, without modifying the body of the Lease in each case.

Use restrictions raise a number of important choices for the CLT. A private agreement like a lease can prohibit some uses permitted by local zoning, but cannot permit uses which local zoning prohibits. Therefore, the effect of Section 4.1 is to "freeze" the allowable uses according to zoning at the time the Lease begins unless zoning itself later becomes more restrictive. The CLT must question carefully whether the existing zoning furthers its policies and priorities. It must also consider whether uses that come to be permitted by local zoning in the future should automatically be permitted under the Lease. For instance, if later zoning regulations allow commercial uses of the property, should the CLT allow such use? Most CLTs want to prevent commercial uses from replacing residential use, but many may not want to freeze in current zoning provisions regarding uses incidental to residential use, since the nature of appropriate incidental uses may change substantially in 99 years and it may be appropriate in the future to allow certain uses prohibited by zoning at the time the Lease commences.

In deciding these questions, the CLT must consider its own view on the balance between individual interests and community interests and should not simply adopt local zoning without carefully considering the possible consequences.

Finally, although the Model Lease assumes a residential use, CLTs sometimes lease to businesses, nonprofits and social service providers. Such cases are likely to call for a very different set of use provisions (see Chapter 16, "Other Ground Leases").

### **Section 4.2 Responsible Use and Compliance with Law**

This section imposes a general obligation of responsible use of the property. It could be tailored to include specific obligations for particular leaseholds, such as an obligation to maintain the productive capacity of agricultural land (or such specific obligations may be included in an attached Exhibit, like the restrictions noted above). The section also establishes as a condition of the Lease the requirement that the Leased Land and Home be maintained in accordance with all applicable laws, so that a violation of any such law will constitute a default under the Lease. In addition, the Model explicitly provides that the property must be maintained "in such condition as is required to maintain the insurance

coverage required by Section 9.4 of this Lease.” This provision is implicit in Section 9.4 itself but is included here to emphasize it as one of several significant criteria for required maintenance.

### **Section 4.3 Responsible for Others**

This section makes it clear that the obligations under the Lease remain the Homeowner’s even if the violation of the Lease is caused by someone else who is on the Leased Land with Homeowner’s consent.

### **Section 4.4 Occupancy**

The owner-occupancy requirement established by this section is an important feature of CLT homeownership programs, and thus of the CLT residential Lease. The Model Lease leaves the exact definition of the requirement up to the individual CLT, but CLT leases typically require occupancy for at least eight months – and sometimes as much as ten or even eleven months – out of each year of the Lease. This restriction does limit the Homeowner’s flexibility, but it is usually assumed that a CLT will in fact grant permission for extended absence when there are legitimate reasons for such an absence in a particular year. In any case, new CLTs are encouraged to consider carefully the exact number of months their Lease will require Homeowners to occupy the home each year when they do not have specific permission to do otherwise.

In states that have adopted legislation defining the rights of “domestic partners” CLTs will want to revise the second sentence of the section to read “Occupancy by Homeowner’s spouse or *domestic partner*... shall be considered occupancy by Homeowner.” (In states that neither legally define “domestic partners” nor allow same-sex marriage, the best way to protect the rights of a person in such a role is of course to see that the person is named as co-owner and co-lessee.)

The last sentence in this section 4.4 makes it clear that neither compliance with the occupancy requirement nor CLT’s specific permission for an extended absence constitutes permission to sublease the Home. Permission to sublease must be sought separately in accordance with the following Section 4.5.

### **Section 4.5 Subleasing**

The issue of subleasing, which was addressed in Article 11 in previous versions of the Model, is now addressed here in Article 4, since it is an issue that is often raised in connection with the separate issue of occupancy addressed in 4.4.

To protect Homeowners against the failure of a CLT to respond to a reasonable request for permission to sublease, you may wish to add to this section a sentence stating that a failure to respond within a specified period of time following Homeowner’s written request shall be construed as consent.

When a CLT does permit a Homeowner to sublease the Leased Land and Home for some period of time, the usual assumption is that the sublessee should pay a reasonable fee for use of the property but that the Homeowner should not profit unduly. In applying this principle, some CLTs may wish to modify the description of the amount that can be charged as presented in “condition b.”

### **Section 4.6 Inspection**

This section involves sensitive policy questions that must be addressed by individual CLTs. Each CLT must decide for itself on the exact nature of the inspection rights it will retain. Each must decide how frequently inspections should be permitted and how much

advance notice should be required. Each must also decide whether the right to inspect the Leased Land will include or exclude the right to inspect the interiors of buildings. In the Model Lease, the right to inspect the interiors of buildings is explicitly excluded. The CLT should carefully consider whether it will allow the additional degree of privacy provided by this exclusion, or whether it feels the right to inspect interiors of buildings is necessary if the CLT is to carry out its stewardship responsibilities. This 2011 Model does give the CLT the right to inspect the interiors of buildings after a homeowner has given notice of intent to sell, so the CLT can determine whether there is a need for interior repairs that will need to be addressed before the Home can be sold (note also that Section 10.13 calls for inspection by a professional building inspector at this time). You may also decide that the CLT should be given the right to inspect interiors of buildings in the case of emergencies.

Not surprisingly, the drafting of this section of a new CLT Lease often involves considerable debate between those especially concerned with guaranteeing the rights of privacy usually associated with homeownership and those especially concerned with the CLT's ability to monitor and preserve the quality of housing in which the community has invested. Such debate is appropriate and should not be avoided. The differing perspectives should be thoroughly aired and a reasonable balance should be agreed upon. In this connection, it is important to emphasize that, by establishing a right to inspect the Leased Land, a CLT does not commit itself to a policy of regular inspections. For some CLTs it may be the case that the right will be exercised only if there is reason to think that serious damage is being done to the Home or that the Homeowner's use of the Leased Land is endangering others. It should also be noted that conventional mortgages give the mortgagee a comparable (and often less specifically limited) right of inspection.

#### **Section 4.7 Homeowner's Right to Quiet Enjoyment**

This section is intended to comfort the Homeowner by declaring that the CLT's role should be limited to avoid undue interference with the Homeowner's enjoyment of the Leased Land. The term "quiet enjoyment," has a technical legal connotation concerning the right to continued possession of real property without being "dispossessed" by any party.

### **ARTICLE 5: Lease Fee**

A detailed discussion of the concept of the CLT Lease fee and the various approaches to its definition and calculation can be found in Chapter 13, "Establishing and Collecting Fees." The approach to the lease fee taken in the Model Lease has changed over the years. In early versions of the Model, the fee was defined as the sum of a set of specified components, including the taxes on the land, as well as an "administrative charge" and a "land use charge." In later versions, taxes on the land are not charged to the homeowner as a component of the lease fee (the homeowner is required to pay them directly), and the "land use charge" and "administrative charge" are no longer distinguished from each other. Thus, in the 2002 version of the Model, the lease fee is treated as a single amount paid to the CLT as compensation for use of the land – and usable by the CLT for whatever purposes it sees fit. In this 2011 version of the Model, however, the fee is once again treated as the sum of two components – a "land use fee" and a "repair reserve fee," as explained below.

#### **Section 5.1 Amount of Lease Fee**

Although the fee consists of two components, the dollar amounts of both components can be established when the lease is executed (unlike the "pass-through" components of earlier

models that included taxes, etc., and needed to be adjusted from year to year). The Land Use Fee can be used by the CLT for any purpose it sees fit, but the use of the “Repair Reserve Fee” (called a “stewardship fee” in some CLT leases) is restricted to “preserving the physical quality of the Home for the long term.” It is normally assumed that this restricted purpose will be served through the establishment of some form of “repair reserve fund.” How such a fund will be managed and allocated is to be described in Section 7.6, which is reserved for this purpose. See the commentary on Section 7.6 regarding potential approaches to this subject.

If you choose not to establish a repair reserve – or not to fund such a reserve through a monthly fee – you can modify this section 5.1 to establish the lease fee as a single amount rather than as the sum of two fees.

### **Section 5.2 Payment of Lease Fee**

CLT lease fees are normally paid on a monthly basis, like other regular housing costs but unlike some other types of ground rent, such as rents for agricultural land, which are often paid annually.

### **Section 5.3 Calculation of Land Use Fee**

*(Note: If the lease fee is to consist of a single amount (with no repair reserve fee), the term “Land Use Fee” should be replaced in this section with the term “Lease Fee.”)*

This section describes the calculation of the Land Use Fee (but not the Repair Reserve Fee) in terms of two basic necessary considerations – fair rental value on the one hand and affordability on the other hand – but it does not spell out a detailed method for applying these considerations. As noted in Chapter 13, “Designing and Collecting Fees,” there is no precise method of calculating the amount by which fair rental value is reduced by the special restrictions imposed by a CLT lease; nonetheless, it is normally assumed that the amount of a CLT lease fee should be *at least somewhat less than* what the fair rental value would be if there were no special restrictions. The method by which affordability is calculated is normally dictated by the requirements of particular funders and lenders – typically the requirement that total monthly housing costs, including mortgage payments, taxes, insurance, and Lease fee, not exceed a specified percentage (e.g. 30%) of gross monthly income.

### **Section 5.4 Reduction or Suspension of Lease Fee**

This section recognizes the CLT’s right to waive all or part of the Lease Fee in a hardship situation. Section 14.6 insures that a waiver or reduction by the CLT in one instance will not obligate it to make the same arrangement in a later instance.

### **Section 5.5 Periodic Increase of Fees**

*(If the lease fee is to consist of a single amount (with no repair reserve fee), this section should be revised to refer to just to the Lease Fee, rather than to the separate Land Use Fee and Repair Reserve Fee.)*

This section allows the CLT to increase either or both of the components of the Lease Fee from time to time, provided the total increase since the date of the execution of the Lease does not exceed the increase in the Consumer Price Index over that time. Several variations of this approach are possible. You may *require* that either or both of the fees be recalculated at specified intervals, rather than just preventing the CLT from increasing them more frequently than once in a specified number of years. You may also choose to call for periodic

recalculation of the Land Use Fee (but not the Repair Reserve Fee) through the same process described in section 5.3, rather than through the CPI-based process. And you may choose to call for separate adjustments of the Repair Reserve Fee based on periodic projections of likely long-term costs of repairs.

It should be noted that some mortgage lenders and mortgage insurers (e.g., FHA) may insist on tighter limitations of the CLT's right to increase the Lease Fee than the CLT would otherwise choose, or may insist on a right to approve any increase in the Fee. Such lender-imposed limitations, if necessary, should be established in a rider to the Lease, applicable only during the term of the mortgage in question, rather than in the body of the Lease.

#### **Section 5.6 Increase in Land Use Fee if Restrictions are Removed**

*(If the lease fee is to consist of a single amount (with no repair reserve fee), the term "Land Use Fee" should be replaced in this section with the term "Lease Fee.")*

This important section allows the CLT to increase the Land Use Fee in the event that resale and/or occupancy restrictions are removed from the lease as a result of a mortgage foreclosure or for any other reason. Since the amount of the Land Use Fee has been calculated as the fair rental value of the land, as restricted by the Lease and adjusted for affordability, it is reasonable to allow this increase to reflect the unrestricted value of the land in a situation where the Home is no longer reserved for lower income owner-occupants. The limitation on the initial amount of the increased fee to a specified dollar amount is intended to address the concerns of mortgagees or buyers who might acquire the home pursuant to foreclosure.

#### **5.7 Late Payment Penalty**

As the penalty is structured here, interest can be charged for late payment as soon as the "due date" is passed, but will be forgiven if payment is made within 30 days of the due date. This approach gives the CLT a bit of added leverage when it notifies the Homeowner, during the 30-day period, that the payment has not been received.

#### **5.8 Collection of Unpaid Fees from Proceeds of Sale**

This section explicitly provides for collection of any unpaid lease fees by the CLT out of the Homeowner's proceeds when the Home is sold. The last sentence of the section strengthens the CLT's hand in this matter by providing for a lien on the Home. Nonetheless, in a situation where a significant amount is owed, the CLT should consult with its attorney regarding actions that may need to be taken to ensure full enforceability of this provision.

### **ARTICLE 6: Taxes and Assessments**

#### **Sections 6.1 and 6.2 Taxes and Assessments**

In this version of the Model these sections assign responsibility for taxes on the Leased Land as well as on the Home directly to the Homeowner. As noted above, it is also possible for the CLT to pay the taxes on the land but to pass this cost on to the Homeowner as a component of the Lease Fee. (If a CLT adopts the latter approach, its lease should address the question of the Homeowner's recourse in the event that the CLT *fails* to pay the taxes on the land).

See Chapter 13, "Designing and Collecting Fees," for discussion of the advantages and disadvantages of the two approaches.

#### **Section 6.3 Homeowner's Right to Contest**

Jurisdictions may differ somewhat on whether a ground lessee can contest real estate taxes

in her own name. For example, in Massachusetts, any tenant having an obligation to pay more than 50% of the taxes on a property can contest real estate taxes in her own right (although a tenant, unlike an owner, must pay the taxes first and then file for an abatement).<sup>1</sup> This section 6.3 clarifies that Homeowner can do so, even if the law does not grant such a right, by providing that the CLT shall join in such abatement proceeding in response to a “reasonable request from Homeowner for assistance in this matter.”

#### **Section 6.4 Payments in Event of Delinquency**

This section specifically allows the CLT to add to the Lease Fee any delinquent taxes or assessments on the Home and/or the Land.

### **ARTICLE 7: The Home**

#### **Section 7.1 Ownership of Improvements (the Home)**

The Home is owned by the Homeowner. This separation of ownership of land and buildings is at the core of the CLT approach to ownership (see Chapter 10, “Legal Issues Re. CLR Ownership,” where this principle is discussed, along with some variations from it). Nevertheless, the ownership of the Home is intended to be subject and subordinate to the Lease; that is, the Lease imposes some limits on the usual rights of ownership of the Home. Especially important is the question of whether at the end of the lease term (or sooner) the Home – or any permanent part of the Home – can be “severed” from the Leased Land and moved elsewhere. Commercial Leases typically prohibit such severance and provide for a forfeiture of the title to any leasehold improvements to the lessor at the end of the lease term. Section 7.7 follows this practice but requires that the CLT compensate the Homeowner. However, in some states a ground lessee’s ownership of the Home may in part turn on having the right to sever. (See comments on Section 7.6 below.)

The current version of the Model states that “Homeowner shall not remove any part of the Home from the Leased Land without CLT’s prior written consent.” You may wish to modify this statement to read, “...without the prior written consent of the CLT and any Permitted Mortgagees.” (Mortgagees have generally not insisted on this provision, but the lack of it has been questioned in at least one instance, and its inclusion would be reasonable.)

#### **Section 7.2 Purchase of Home by Homeowner**

A deed is used for conveyance rather than a bill of sale to signify that the Home is to be considered as real (rather than personal) property. However, some jurisdictions may consider the Home technically to be personal property, in which case a bill of sale will be the appropriate instrument.

#### **Section 7.3 Construction and Alteration**

The CLT has a fundamental interest in preserving the quality of the permanently affordable housing on its land and protecting future residents of the property against inferior work. Some CLTs have gone further than the Model Lease and have required prior approval of all construction – at least where the home in question is newly constructed and where there should be little need for further construction and where inappropriate changes by residents may interfere with a carefully developed design.

The second paragraph of this section, spelling out a process to be followed in situations where the CLT’s approval is required for major alterations, was added in this 2011 version of the Model Lease. You may wish to modify the details. And to protect Homeowners against the failure of a CLT to respond within the specified two-week period, you may wish to add to

this section a sentence stating that a failure to respond in the specified period of time following Homeowner's written request shall be construed as consent.

It should be emphasized that CLTs using resale formulas that include a "capital improvement credit" will need to specify a different or additional process for handling situations in which a Homeowner requests not only that certain construction be permitted but that its value be added into the purchase option price. The latter process would be described in Article 10 in connection with the resale formula. It is possible to combine or coordinate the processes, but it is important that the two issues – consent for construction as such and approval of a capital improvement credit – not be confused.

#### **Section 7.4 Prohibition of Liens**

Liens are a potential threat to the CLT's title to the Land and to the transferability of CLT Homes, so the provisions of this section are designed to prohibit all liens (other than permitted mortgage liens). In some situations involving the Home and/or the Homeowner, however, some party may need to protect itself against non-payment by filing such liens. The provisions for "bonding-off" liens put the burden on the Homeowner to make arrangements for a source (other than the property) of payment of any meritorious claim while the claim is being resolved. Note that generally a "prohibition of liens" such as that contained in this section cannot defeat the rights of certain parties to obtain a lien under local law. Rather, the provision just bars the Homeowner from allowing such a lien to occur and remain in place.

#### **Section 7.5 Maintenance and Services**

Supplementing the provisions of Section 4.2 with specific reference to the lessee-owned Home, these provisions are intended to see that the Home will remain in good condition, both to protect residents and to minimize the possible CLT liability. The section also explicitly establishes that the Homeowner is responsible not only for routine maintenance but for any major repairs or replacements that become necessary.

#### **Section 7.6 Repair Reserve Fund**

Model provisions for a repair reserve fund are not included in the body of the Model Lease, but Section 7.6 is "reserved" for this subject, and it is recommended that CLTs establish some form of repair reserve. A number of factors should be considered before deciding on a particular approach to such a reserve fund. In one way or another, however, a CLT must deal with the question of how the necessary long-term reinvestment in the home is to be ensured.

Designing a reserve for repairs and replacements entails two sets of questions: (1) how to fund such a reserve, and (2) how to manage and allocate the reserve to pay for repairs.

*Funding.* The reserve may be funded by charging the homeowner a monthly fee and/or by collecting a single larger sum when the home changes hands (as a separately designated percentage of the purchase price when the initial homeowner buys or as a component of a "transfer fee" upon resale). The monthly fee is probably the more common approach among CLTs, though some rely, at least in part, on committing a larger sum to this purpose at the time of transfer. In this 2011 version of the Model Lease, Section 5.1 establishes a Repair Reserve Fee as a component of the Lease Fee but does not state how the funds are to be used.

Note that Section 10.12 or 10.13 (depending on which version of Article 10 is used) provides for a transfer fee "to compensate the CLT for carrying out its responsibilities with regard to the [resale] transaction," but does not provide for use of the fee to assist with repairs

for which the Homeowner is responsible. The section might be modified, however, to allow this use.

*Management and allocation of funds.* There are a number of issues that a CLT must address in deciding how to manage and allocate a reserve fund. The decision will depend in part on circumstances specific to the particular CLT (involving both the capacity of the organization and the type of housing with which it deals), so we are not proposing a specific model at this time, but it is important that each CLT consider the issues carefully and then develop clearly defined policies that will avoid confusion and the potential for disagreement between CLT and homeowners.

1. The first question is whether there will be a separate reserve fund for each home, to be used only for repairs on that particular home, or whether there will be a single fund for all of the CLT's homes, to be used wherever it is needed. Both are possible, though at this time most CLTs that have established repair reserve funds have maintained separate reserves for each home. Maintenance of a single master fund does provide more flexibility for the CLT in dealing with major repairs, but it creates the potential for resentment by those homeowners who have paid into the fund and then find that they have contributed more to the repair of someone else's home than to their own.
2. If house-by-house reserves are maintained, the next question is whether the funds can be withdrawn by the homeowner when she sells the home, or whether the funds will "stay with the home." If the reserve is seen only as the equivalent of a rental damage deposit, then it is reasonable to allow the homeowner to withdraw whatever remains in the reserve when the home is sold. However, most CLTs that maintain such reserves see them not as a deposit against undue damage but as a way of accruing funds to pay for those replacements and repairs for which a need accrues inevitably in due course – for instance, to pay for a new roof when the original roof has eventually been "used up." A homeowner who sells a home after having used up only half of the life expectancy of the original roof will not have occasion to draw on the reserve for roof repair, yet it is reasonable for that homeowner to contribute toward the cost of what she has used. It must be acknowledged, however, that what is reasonable with some other types of repairs is less clear. The homeowner who has faithfully performed the maintenance tasks necessary to avoid or forestall certain types of repairs may not have occasion to draw on the reserve for those repairs, and may therefore feel that she has been required to pay twice for the maintenance of her home.
3. The question then is what exactly should such reserves be used for. A range of approaches is possible.
  - One approach, particularly appropriate for new homes, is to state in the lease a specific list of items for which funds can be used. Usually the idea is to include major items that have rather well defined life expectancies, regardless of year-to-year home maintenance efforts. Items such as roofs and exterior paint clearly fall into this category, but with many other items it becomes more difficult to distinguish between *inevitable* life expectancies and life expectancies that vary greatly depending on intensity of use and consistency of maintenance. If an explicit list is included in the lease, it may be presented as a list of the *only* items for which the reserve funds can be used, or it can be presented as a non-exclusive list of items that can be expected to qualify for use of the funds, so that other kinds of replacements and repairs can also be

- funded if they meet certain criteria.
- A somewhat different approach is to establish an explicit list as a matter of policy but not to include it in the lease, so that it can be modified without amending the lease. In such case the lease may simply state that the reserve fund shall be used for purposes consistent with duly approved CLT board policy. This approach may be more appropriate for older homes where the life-expectancy of specific components at the time the home is purchased will vary substantially from home to home – and of course from original purchase to resale. (You may also address such variables through customized exhibits attached to leases on a home-by-home basis.)
  - The CLT may also be given more flexibility by stating in the lease basic criteria for the allocation of funds, rather than specific uses. Policy statements that are not included in the lease may or may not then provide specifically for the application of the criteria to different kinds of repairs. Any statement of what the reserve *can* be used for (whether containing an explicit list of items or not) should normally be accompanied by a statement of the kinds of things that it *cannot* not be used for. Such proscribed uses of the reserve typically include replacement of original components with expensive components or materials that are significantly more luxuries, but not more functional or durable, than the originals; and replacements or repairs that are necessitated by the homeowner’s misuse or neglect rather than normal wear and tear. The application of such provisions may of course involve conflicting views of what is or is not luxurious and what does or does not constitute misuse or neglect, but it is generally wise to establish the principles even if they are applied only in extreme cases.
  - The lease and/or CLT policies may or may not provide explicitly for use of the reserve to pay for repairs that may be required (as under Section 10.13 or 10.14) at the time of resale.

### **Section 7.7 Disposition of Home upon Expiration of Lease Term**

If the Lease were silent on the matter, in some jurisdictions the Homeowner might be able to “sever” the improvements from the Leased Land and move them elsewhere when the Lease expires or terminates. Some CLTs do permit severance but specify certain conditions (e.g., Homeowner must repair all damage to the Land). See Chapter 10, “Legal Issues Re. CLT Ownership,” for further discussion of this matter.

Regarding the CLT’s obligation to compensation the Homeowner upon the reversion of ownership, this 2011 version of the section, unlike past versions, provides explicitly for full payment to Permitted Mortgagees before any amount is paid to the Homeowner. The current version also explicitly holds the Homeowner responsible for clearing any liens on the improvement at the time of reversion, or for reimbursing the CLT for its costs in clearing such liens, including attorney’s fees.

In the current Model Lease, the CLT is required to pay for the improvements regardless of whether the Lease has expired or has been terminated as a result of a default by Homeowner. However, some CLT leases (and early versions of the Model) impose this requirement *only* in the case of expiration of the full term of the Lease, leaving the CLT (or a successor lessor) without an obligation to pay for the Home if the Lease is “sooner terminated” as a result of a default by Homeowner. New CLTs should weigh the additional protection for the

Homeowner that is provided by the current version against the additional protection for the CLT provided by the alternative version. In any event, however, it should be noted that the CLT cannot terminate the lease without paying whatever is owed to – or otherwise accommodating the interests of – any Permitted Mortgagees (see “Permitted Mortgage Exhibit,” Section B).

**Note:** the second paragraph of the current version states: “CLT shall pay any Permitted Mortgagee(s) the full amount owed to such mortgagee(s) by Homeowner.” The intent of the drafters was to make it clear that Permitted Mortgagees are to be paid the full amount owed to them *in so far as the total payment does not exceed the purchase option price*. The following alternative language is more precise.

“CLT shall pay any Permitted Mortgagee(s) the amount owed to such mortgagee(s) by Homeowner in so far as that amount does not exceed the Purchase Option Price. In no event shall the total amount that CLT is required to pay Permitted Mortgagees be greater than the Purchase Option Price.

## **ARTICLE 8: Financing**

For a thorough discussion of leasehold mortgages and the issues that they raise for mortgage lenders and for CLTs, see Chapter 20, “Financing CLT Homes.”

The CLT has important reasons for overseeing the Homeowner’s access to mortgage financing. Regarding any proposed mortgage financing, the CLT wants to be sure (a) that the mortgage lender is fully aware of the terms of the Lease, (b) that the CLT’s fee interest in the land is not mortgaged or otherwise endangered, (c) that the total amount of debt, the repayment schedule, and other terms of the loan are reasonable and manageable for the lower-income Homeowner, (d) that in the event of a mortgage default the CLT will have every possible opportunity to prevent foreclosure, not only for the Homeowner’s sake but for the sake of preserving the public’s investment in the Home, and (e) that, in the event a foreclosure is unavoidable, the CLT will have the best possible chance to regain control of the home for future lower income owner-occupants.

For these reasons, the Lease allows only “Permitted Mortgages.” In past versions of the Model, a Permitted Mortgage was defined as any mortgage that was permitted in writing by the CLT *and* that included (in the mortgage document or related documents) certain provisions, protective of the CLT’s interest, that are not common to conventional mortgages. In practice, however, CLTs generally agreed to permit mortgages for which these provisions were not written into the documents. The 2002 edition of the CLT Legal Manual contains a model Permitted Mortgage Agreement, which, it was suggested, CLTs should ask mortgagees to sign. However, such written agreements with mortgagees have continued to be rare. Therefore, the current Model Lease takes a somewhat different approach, as described in the commentary that follows.

### **Section 8.1 Definition of Permitted Mortgage**

In this 2011 version of the Model, the term “Permitted Mortgage” is defined simply as any mortgage that the CLT has permitted in writing.

### **Section 8.2 CLT Permits Original Mortgages by Signing Lease.**

This version of the Model explicitly incorporates something that, in the past, has often been assumed but not explicitly stated. At the time when the Homeowner acquires the Home

and the rights to the Leased Land, the CLT has usually been working closely with the Homeowner to see that appropriate financing is arranged. The CLT is necessarily in position to know what kind of financing has been arranged before the CLT proceeds to sign the Lease. For this reason it seems unnecessary to require the signing of a separate “permitted mortgage document” at that time. If the CLT finds the proposed mortgage financing unacceptable it will not sign the Lease and Deed.

### **Section 8.3 Permission for Refinancing or Other Subsequent Mortgages**

At any time subsequent to the closing of the original transaction it is possible for the homeowner to seek refinancing or additional financing without the CLT necessarily being aware. In such situations it is important that the Homeowner be required to provide essential information about the financing to the CLT and get specific written permission from the CLT before proceeding. Refinancing and second mortgage financing are a particular concern because they may allow the Homeowner to assume additional debt on terms that she cannot realistically manage – and may possibly result in total debt that is greater than the purchase option price. Careful lenders should of course share these concerns. In reality, however, lenders have sometimes made (non-permitted) loans to CLT Homeowners without even realizing that a ground lease existed, much less that it contained resale price restrictions.

The Model Lease requires that the Homeowner inform the CLT of the proposed terms and conditions of any such mortgage loan at least 15 business days prior to the expected closing of the loan. Some CLTs may wish to stipulate a different minimum number of days. Some may also wish to modify or expand the list of information that must be provided to the CLT – or may wish to revise the section to state that the Homeowner must notify CLT of its intention and that the CLT will *then* inform Homeowner of the specific information its current policy requires be submitted before approval can be granted.

The final sentence of the section establishes basic criteria for the CLT’s approval of such loans. One such criterion is the maximum ratio of total mortgage debt to the Purchase Option Price. In the Model, the percentage is left blank. A CLT must either fill in a specified percentage or, perhaps, eliminate the specific requirement from the Lease and deal with this issue in terms of policy that the organization may modify from time to time. Among those CLTs that have established specific maximum ratios, the common range is from a conservative 80% up to 100%. (It should be noted that no CLT would want to prohibit a homeowner from refinancing her original first mortgage debt on favorable terms that reduced her monthly payment, even if the total debt exceeded some prescribed percentage of the purchase option price.)

To protect Homeowners against the failure of a CLT to respond to a reasonable request for permission to refinance, you may wish to add to this section a sentence stating that a failure to respond in a specified period of time following Homeowner’s written request shall be construed as consent to the requested financing.

### **Section 8.4 Standard Permitted Mortgage**

While the CLT is not required to permit most mortgages, it is required to permit mortgages that meet all of the relatively strict conditions laid out for a “Standard Permitted Mortgage,” including the condition that the mortgagee enter into a “Standard Permitted Mortgage Agreement” that conforms with the model document presented in the Permitted Mortgages Exhibit, Part C. The intent of this provision is to protect the Homeowner in a

situation where an owner of the land might want to prevent a sale of the Home by refusing to permit *any* mortgage.

With regard to the blank that must be filled in to indicate the maximum allowable percentage of mortgage debt to purchase option price, the usual expectation is that the matter will be handled in the same way as in Section 8.3 above.

### **Section 8.5 Obligations of a Permitted Mortgagee**

With the approach taken in this 2011 version of the Model, the basic protections for CLT and Homeowner that the CLT would like to ensure are treated as conditions of the lease itself, binding on any Permitted Mortgagee unless CLT and Homeowner have executed a lease rider that modifies or contravenes the stated obligations. On this matter, the current version of the Model departs from the earlier strategy of asking (in theory) that the mortgagee include these conditions in mortgage documents or sign a separate document agreeing to such protections. If such a Permitted Mortgage Agreement is signed by a mortgagee, it might be more strictly enforceable than the current provisions of this section 8.5 regarding mortgagee obligations, but the reality is that mortgagees have rarely agreed to sign such a document (and probably were not asked). In the past, what actually happened in most cases was that CLTs, after negotiating the most favorable terms possible, went ahead and permitted the mortgages anyway.

In such situations, whatever conditions were agreed upon in negotiations between Permitted Mortgagee and CLT were often incorporated in lease riders (like the Fannie Mae Uniform CLT Ground Lease Rider) which were signed by the Homeowner and the CLT but not by the mortgagee. The current approach accepts the reality that a mortgagee may insist on such a lease rider. But, in turn, it establishes the obligations of a Permitted Mortgagee as conditions of the Lease itself (defining an essential element of the collateral for the leasehold mortgage) except in so far as any of these obligations are removed or altered by a lease rider.

In the current approach we have also eliminated the requirement that the “cure period” (the time in which the CLT has a right to cure a Homeowner’s mortgage default) must last a specified number of days – a definition that in the past was usually either ignored or modified by a lease rider. The cure period is now defined simply as “that period of time in which the *Homeowner* [emphasis added] has a right to cure such default” (Exhibit: Permitted Mortgages, Section A-1).

It should be emphasized that any concessions made to specific mortgagees should always be incorporated in a rider to the lease (binding only for the life of the mortgage), not in the lease itself.

### **Section 8.6 Rights of Permitted Mortgagees**

Like the obligations of a Permitted Mortgagee, the rights of a Permitted Mortgagee stated in the Permitted Mortgage Exhibit can be modified or supplemented by a lease rider.

The rights stated here are those that most careful lenders will insist on having guaranteed to them. The fact that the Lease does guarantee them only for *Permitted* Mortgagees provides some important protection for both the Homeowner and the CLT. If the CLT ever discovers that the Homeowner has in fact granted a mortgage on her property that does not meet the requirements of a Standard Permitted Mortgage and that has not otherwise been permitted by the CLT, the mortgagee can be advised that it does not have the rights specifically assigned to Permitted Mortgagees by the Lease (including the right to prevent the termination of the Lease in the event of a default under the Lease by the Homeowner), and it can be advised that

the mortgaging of the Home and leasehold interest without the CLT's permission constitutes a default under the Lease which could lead to termination. Given these circumstances, it is likely that the mortgagee will choose to come to terms with the CLT.

In past versions of the Model, two specific rights of the Permitted Mortgagee – the right to have resale restrictions removed from the Lease pursuant to foreclosure, and the right to approve amendments of the Lease before they become effective – were stated in the body of Article 8 rather than in the Permitted Mortgage Exhibit. In the 2011 version, however, these rights are included in the Exhibit, so that all Permitted Mortgagee rights can be found together in one place.

#### **Section 8.7 CLT's Right to Proceeds in Excess of Purchase Option Price**

This provision addresses a situation that could arise if the home is sold, pursuant to foreclosure, for an amount that would allow the Homeowner, after the mortgagee is paid in full, to realize proceeds in excess of what is permitted by the resale restrictions in Article 10. The enforceability of this provision may vary depending on state laws relating to foreclosure, but it remains important that the Lease contain language whereby, as far as is legally possible, the Homeowner explicitly gives up any claim to such excess proceeds.

### **ARTICLE 9: Liability, Insurance, Damage and Destruction, Eminent Domain**

Most of the provisions of this article are similar to standard provisions for liability and casualty matters found in most long-term leases. The Model is careful, however, to limit the value that can be taken away by the Homeowner and to protect the CLT's right to preserve the value invested in the Home as well as the land by the public.

For a discussion of liability issues affecting long-term ground lessors and ground lessees, see Chapter 10, "Legal Issues Re. CLT Ownership."

#### **Section 9.5 Damage or Destruction.**

This section limits the Homeowner's right to terminate the Lease in the event of a fire or other casualty if insurance proceeds will not fully pay for restoration. In the 2011 version of the Model, however, these limitations are not as rigidly defined as in previous versions. Whereas past versions of Section 9.5 allow termination of the Lease by the Homeowner only if damage is such that insurance proceeds will cover less than 80% of the cost of restoration, the present version abandons the "80% criterion," on the grounds that it potentially leaves a low-income homeowner responsible for paying higher restoration costs than are likely to be affordable for such a person. Instead, this version calls for the CLT to help find a way to cover any costs that are not covered by insurance and not affordable for the Homeowner. If a way to cover these costs cannot be found that is acceptable to both parties, then the Homeowner can terminate the Lease.

If the Lease is terminated, the Homeowner cannot receive more from the insurance proceeds than the Purchase Option Price allowed under Article 10, thus eliminating any possible incentive to use arson as a means of avoiding the equity limitations of the Lease. The 2011 version of section 9.5 also ensures that if the Lease is terminated, "the expenses of enclosing or razing the remains of the Home and clearing debris" must be paid out of the insurance proceeds before any proceeds are paid to the Homeowner.

Note that in this section the Purchase Option price is to be determined "as of immediately prior to the damage." For CLTs with appraisal-based resale formulas, this situation may

require an appraiser to calculate the value of what can no longer be observed. However, methods for such calculations have been developed and can be employed by a professional appraiser. The possible need for determining the value of something that has been lost or damaged is not unique to CLTs.

### **Section 9.6 Eminent Domain**

In the 2011 version of the Model, provisions for allocating the amount of an award between CLT and Homeowner are somewhat simpler than in previous versions and are more closely parallel to provisions relating to allocation of insurance proceeds in the event of damage or destruction.

## **ARTICLE 10: Transfer, Sale, or Disposition of Home**

For this 2011 version of the Model Lease, four possible versions of Article 10 are presented (in the Appendix at the end of Chapter 11-A). These versions differ with regard to three important variables: (1) whether the homeowner is given an absolute right to select an income-qualified buyer, (2) the type of resale formula that is used, and (3) whether the original Base Price is (or may be) greater than the original appraised value of the Home. No one of these versions is offered as THE model. Every CLT must make important decisions before adopting one of these versions (or its own variation of one of these versions).

In the commentary offered here we will first discuss all sections of “Version 1.” We will then discuss those features of “Version 2,” “Version 3” and “Version 4” that differ from comparable features of Version 1.

### ***VERSION 1***

In which:

- a) The Homeowner does *not* have an absolute right to identify a buyer.
- b) An “improvements-only appraisal-based formula” is used.
- c) The original Base Price is *not* greater than the original appraised value of the Home

### **Section 10.1 Intent**

Article 10 is of course a very important part of the Lease, as it spells out the process by which affordability is to be preserved and the transfer of the Home is to be regulated. Section 10.1 is included to reinforce the acknowledgment by all parties involved that the limitations on resale, though not found in conventional housing transaction, are appropriate and willingly accepted in this context.

### **Section 10.2 Transfers to Income-Qualified Persons**

This section states explicitly that the Home and the Homeowner’s interest in the Leased Land can be transferred *only* in accordance with the sections that follow and that any other “purported transfer” shall be null and void.

It is important that the definition of Income-Qualified Person be precisely what is intended for each CLT leasehold. Some CLTs may apply the same definition to all of their leaseholds, but some define income qualifications differently depending on the level of affordability initially achieved and on the level required by a subsidy source. Thus some deeply subsidized homes may be reserved for buyers with household incomes below 60% of median income. Others may be available to buyers with household incomes below 80% of median income. Still others may be available to buyers with household incomes below 100% or 115% of median income. In any case, one should avoid the mistake made by some early CLTs that

defined income qualifications simply as “low income household” or “low and moderate income household,” since there is no universally applicable quantitative definition of these terms.

### **Section 10.3 Transfer to Homeowner’s Heirs**

The intent of this section is not to limit the Homeowner’s right to bequeath the value of the Home, as an asset, to any person or persons of the Homeowner’s choosing. The intent is to limit the categories of individuals that will have a right, upon inheritance, to assume the Lease and occupy the Leased Land on a continuing basis. Most CLT leases, like the Model, limit this right to spouses and children of the Homeowner and established members of the Homeowner’s household, as well as those who are Income-Qualified Persons. Anyone outside of these categories may inherit the value of the (resale-restricted) asset but may not occupy the home as a permanent resident-owner. To realize the value of the asset in such cases, the property must be sold in accordance with the resale restrictions established in this Article 10.

Some CLTs have modified this Section so that it applies not only in the event of Homeowner’s death but also in the event that Homeowner chooses to transfer title, while living, to a person or persons who would qualify as transferees if Homeowner had died after naming them as heirs. In such cases the initial sentence may be revised to read “Upon the receipt of a written request from Homeowner at any time or upon receipt of notice from the executor...”

In states where legislation has given legal definition to the role of “domestic partner,” most CLTs will want to include “domestic partner” as well as “spouse” among those eligible to assume the Lease.

It should be noted that some subsidy sources will impose different eligibility requirements. A number of sources do not allow transfer to members of the household who are neither spouse nor children of the Homeowner (category “c”) unless they are income-qualified. In these cases the usual practice is to attach a rider to the lease modifying this section for so long as a regulatory agreement with the funder is in effect.

Letters of Understanding and Attorney’s Acknowledgment must be signed, submitted and attached to a lease as a condition of its assignment to an heir. This requirement is intended to prevent the problems that could arise if a person who had never specifically accepted the restrictions contained in the Lease were to become the Homeowner by inheritance.

### **Section 10.4 Homeowner’s Notice of Intent to Sell**

This section requires that the Intent-to-Sell Notice “include a statement as to whether the Homeowner wishes to recommend a prospective buyer as of the date of the Notice,” but does not require the CLT to accept the recommendation. Homeowner may also recommend a prospective buyer at a later time. See Section 10.6 regarding CLT’s response to such recommendations.

### **Section 10.5 Appraisal**

This section deals with the appraisal that will be required to determine the purchase option price if an “improvements-only appraisal-based formula” is used. If either a “simple appraisal-based formula” or a “compound appraisal-based formula” is used, then you can omit the sentence that states, “The Appraisal shall state the values contributed by the Leased Land and by the Home (consisting of improvements only) as separate amounts.” (See Chapter 12,

“Resale Formula Design,” regarding the three types of appraisal-based formula.)

This version of the Model requires the *CLT* to commission and pay for the appraisal, whereas earlier versions of the Model (and a number of *CLT* Leases based on it) required the *Homeowner* to commission and pay for the appraisal when it is necessary to the application of an “appraisal-based” formula. The rationale for shifting responsibility to the *CLT* is that (a) appraisals are usually the responsibility of the buyer, not the seller, and (b) the *CLT* will normally be in a better position – with more experience and contacts – to see that the task is appropriately carried out. It is of course possible to require the *CLT* to commission the appraisal but to allow it then to charge all or part of the cost to the *Homeowner*.

It should be emphasized that the appraisal required here is one that is conducted “as though title to Leased Land and Home were held in fee simple absolute.” The appraised value of the property should not be discounted to reflect a reduction in value resulting from the restrictions imposed by the Lease. In applying an appraisal-based resale formula, the purpose of the appraisal is to determine how much the value of the Home *would have* increased in the absence of lease restrictions. The restrictions then allocate *a part* of this market appreciation to the *Homeowner*.

In many – perhaps most – cases the appraisal process that is carried out for the purpose of establishing the resale price can also serve the new mortgage lender’s purpose of establishing the market value that the property would have pursuant to foreclosure. Since the resale price restrictions are removed following foreclosure (or the taking of a deed in lieu), the mortgage lender wants to know the value that the collateral would have *in the absence of* those restrictions. However, the collateral with which the lender is concerned consists of the Home *and the leasehold interest in the Land*, whereas the *CLT*, in calculating the price under an improvements-only appraisal-based resale formula, is concerned with the value of the Home alone (unless the original Base Price is greater than the original appraised value of the Home – the situation addressed in Versions 3 and 4). Thus, although the same basic appraisal *process* can serve the purposes of the *CLT* and the mortgage lender, the “*bottom line amounts*” that are finally calculated for the purposes of these two parties will differ. The bottom line for the *CLT* is the value that the Home alone would have without restrictions (or the value that the Home and Leased Land would have without restrictions if a “simple” or “compound” appraisal-based formula is used). The bottom line for the lender is the value that the *Home and leasehold interest* would have without restrictions (See “Chapter 20, “Financing *CLT* Homes,” regarding the valuation of a leasehold interest). The *CLT* should clearly distinguish these amounts and should be careful not to use the wrong amount in calculating the formula price.

When appraisal-based resale formulas are used it is important that an appraisal be completed soon after an intent to sell notice has been given, as provided in this section, so that the Formula Price, and thereupon the Purchase Option Price, can be definitively established as early in the resale process as possible.

#### **Section 10.6 CLT’s Option to Purchase the Home**

The content of this section is identical to that of the comparable section in Versions 3 and 4, but fundamentally different from the content of sections 10.6 and 10.7 in Version 2, which describe the exercise of the Purchase Option in relation to the process by which the *Homeowner*’s right to select a buyer can be exercised.

One of the more important issues that a *CLT* must address in drafting a lease is the

question of whether to retain an absolute right to exercise the Purchase Option (as in Version 1), and thus retain full control of the future use and occupancy of the Home, or whether to allow homeowners to sell their homes to income-qualified buyers of their choice (as in Version 2). CLTs that choose the approach embodied in Version 1 tend to be those that expect to have a waiting list and want to be sure that a home is sold to someone from this list, who has already been oriented and prequalified and has been waiting for an opportunity to buy a CLT home, rather than to a friend of the seller who has not been through the CLT's orientation process and may be less ready for homeownership. For the long-term, Version 1 also assures that the CLT will have an opportunity to change the use of a property at the time of resale – perhaps in a situation where residential use has become less appropriate for some reason and the property would better serve the community's interest if used differently. In such a situation Version 1 assures that the CLT can exercise its option and commit the property to the different use.

### **10.7 If Purchase Option Expires**

Every new CLT should carefully consider how it wants its lease to provide for situations where the purchase option has expired (or purchase under the Option has not been completed) because neither the Homeowner nor the CLT has been able to identify a qualified buyer and the CLT is not able or willing to buy back the home and hold it until a buyer can be found. Such situations are rare for CLTs offering deeply subsidized homeownership opportunities in active housing markets where demand is strong, but are not necessarily rare for CLTs offering less deeply subsidized homeownership opportunities in weaker markets. The Model Lease keeps in place the resale restrictions, as to both the income qualifications of the buyer and the permitted resale price, for a period of six months after the expiration of the CLT's Purchase Option (or the expiration of the 60-day period allowed for completion of the purchase if the Option has been exercised). After the six-month period, if the Homeowner has made diligent efforts to sell the Home and it still has not been sold, restrictions regarding income qualifications are dropped, but the restriction regarding the price is retained (so the home will remain affordable for future low-income buyers even if market conditions change). Some CLTs may want to handle the matter differently – and a subsidy source may insist on a rider that will prevent the expiration of the income restriction during the life of a subsidy agreement.

The Model does not explicitly lay out a process whereby the eligibility of a proposed buyer is to be approved by the CLT once the purchase option has expired. You may wish to add language describing such a process. You may also wish to provide for the possibility that a “dormant” CLT might fail to respond to a request for approval of a proposed buyer in such circumstances. You might, for instance, authorize a subsidy source or other concerned governmental entity to respond in such case.

### **10.8 CLT's Power of Attorney to Conduct Sale**

This section addresses the potentially serious problem that could arise if a Homeowner does not actively pursue the sale of a vacated property after the expiration of the CLT's Purchase Option. The section gives the CLT the right to step in after a long wait (here, one year, but it could be longer or shorter) and attempt to complete the resale of the home.

### **10.9 Calculation of Purchase Option Price**

It should be noted that in early versions of the Model (and in CLT leases still based on those versions) the term “Purchase Option Price” was used to mean what is now identified as

the “Formula Price.” The term “Actual Purchase Option Price” was then used to designate what is now called the “Purchase Option Price.” Not surprisingly the older practice resulted in some confusion and some drafting errors as individual CLTs worked to design their own resale formulas and adapt their leases to accommodate them.

The Section makes it clear that the Purchase Option Price is the maximum price that may be charged in any circumstances, regardless of whether the CLT has exercised its option or the Homeowner is selling the Home directly to another buyer.

In Version 1 and in Version 2, the purchase option price is the lesser of the Formula Price or the appraised value of the Home (improvements only). In versions 3 and 4 the purchase option price is the lesser of the Formula Price or a certain percentage of the appraised value of the whole property (Homeowner’s Ownership Interest), as noted in the commentary on those versions.

#### **10.10 Calculation of the Formula Price**

See Chapter 12, “Resale Formula Design,” for a full discussion, including examples, of the improvements-only appraisal-based formula presented in this version, as well as the other possible types of appraisal-based formula.

As with other types of appraisal-based formulas, the percentage of appreciated value allocated to the homeowner by improvements-only appraisal-based formulas need not be 25%. Though 25% is common, the percentage can be set at higher or lower levels – and the formula can also allow the percentage to increase incrementally with increased years of ownership.

#### **10.11 Qualified Purchaser to Receive New Lease**

Early versions of the Model allowed the existing lease to be assigned to purchasers of the home, rather than requiring the issuance of a new lease. However, as the remaining term of an existing lease diminishes over time, the right to a new full-term lease becomes an increasingly important protection for a purchaser (and thus for a seller in search of a purchaser). Therefore, in practice, most CLTs have chosen to give a new full-term lease to all purchasers. This 2011 version of the Model makes this practice an explicit requirement. It also departs from earlier versions of the model in describing the terms that the new lease must contain. Whereas previous versions gave the purchaser a right to a new lease “substantially the same as” the old lease “in the rights, benefits and obligations assigned to Lessee and Lessor,” the current version states that, “The terms of such lease shall be the same as those of *new leases issued to homebuyers at that time* for land not previously leased by the CLT.” This change was occasioned by the fact that a number of CLTs have found compelling reasons to add significant features to their ground leases, such as provisions for a repair reserve fee (now included as a component of the lease fee in section 5.1 of the Model) and maintenance of repair reserves (see Section 7.6 and related commentary). Such provisions substantially strengthen a CLT’s ability to see that the quality of its homes is preserved over the long term, and it has therefore seemed important that a CLT be able to add such provisions to new leases when existing CLT homes are resold.

#### **10.12 Transfer Fee**

It is clear that money collected by CLTs through a monthly lease fee is not sufficient to cover the costs entailed by their ongoing stewardship responsibilities – particularly the responsibilities involved in overseeing the resale of homes. Many CLTs now do charge a “transfer fee” to cover the costs related to oversight of resale. This section (new in the 2011

Model) introduces language permitting such a fee to be added to the purchase option price and paid to the CLT in all situations where the CLT does not directly exercise its purchase option and take title to the improvements. (If the CLT *does* exercise the purchase option it, does not need the lease to authorize a transfer fee: it can simply mark up the price to the next homebuyer or charge a fee for assigning the option to the next buyer.)

CLT leases that provide for transfer fees generally cap the amount of the fee at percentages of the purchase option price ranging up to 6% (i.e., up to the amount that might be charged by conventional real estate brokers). CLTs can of course waive or reduce the fee as necessary to preserve affordability.

### **10.13 Repair Requirement at Transfer**

The requirement that the Homeowner make necessary repairs at transfer is another provision that is new with the 2011 version of the Model. The section clearly assigns to the Homeowner a responsibility that, in the absence of this provision, the CLT itself might have to assume. The process – with necessary repairs identified through a professional inspection – parallels what is typical with conventional real estate transactions, where the seller normally expects either to pay for such repairs prior to the transaction or to accept a reduced price.

The second paragraph under “d” should be included only if the lease does in fact include provisions for a repair reserve fund (see commentary on Section 7.6).

## ***VERSION 2***

In which:

- a) The Homeowner *does* have an absolute right to select a buyer.
- b) An “improvements-only appraisal-based formula” is used.
- c) The original Base Price is *not* greater than the original appraised value of the Home.

### **Section 10.6 Homeowner Has a Right to Designate a Qualified Buyer**

### **Section 10.7 CLT May Exercise Purchase Option if Homeowner Does Not Sell To a Qualified Buyer**

Version 2 differs from version 1 only in the content of these two sections (which replace the single section 10.6 in Versions 1, 3, and 4). The provisions of these two sections of Version 2 are necessarily more elaborate, since they entail two separate processes and the relationship between them: (a) the process by which the Homeowner is allowed to designate a buyer and (b) the process by which the CLT can exercise its purchase option if the Homeowner does not designate a qualified buyer or does not proceed to sell the Home to a designated buyer.

CLTs that choose this approach are likely to be less concerned with seeing that homes are sold to prequalified buyers from their waiting list (or may have no waiting list), and more concerned with giving their homeowners a significant right usually enjoyed by conventional homeowners – the right to sell the home to whomever they wish. CLTs favoring this approach may in fact want to encourage homeowners to take responsibility for marketing the home themselves, so the CLT will need to spend less staff time on this process.

Section 10.6 requires a Homeowner who has identified a prospective buyer to submit documents that will allow the CLT to determine “that the prospective buyer is an income-qualified person who understands and accepts the terms of the Lease and that the price and other terms of sale are consistent with the terms of the Lease.” The documentation described

here can be modified or supplemented by individual CLTs. The current version does not specify how income-eligibility must be documented but simply calls for “such documentation of household income as CLT’s policies then require for confirmation of a buyer’s income-eligibility.” Some CLTs have developed a form that the Homeowner can use (or is required to use) to report the required information. Some of these CLTs have attached such a form to the Lease as an exhibit. Some have not attached it to the Lease but have made such a form available to a Homeowner who designates a buyer. The advantage of the latter approach is that the form can be modified or updated from time to time without amending the Lease.

### **VERSION 3**

In which:

- a) The Homeowner does *not* have an absolute right to identify a buyer.
- b) A “compound appraisal-based” formula is used.
- c) The original Base Price *is* (or *may be*) greater than the original appraised value of the Home.

Version 3 uses a “compound appraisal-based formula,” which gives the Homeowner a specified share of any appreciated value of the “Homeowner’s Ownership Interest rather than the appreciated value of the improvements alone. The Homeowner’s Ownership Interest is defined as that portion of the original appraised value of the entire property (land and improvements) that the Homeowner has paid for through the original Base Price.

Though they are a reasonable approach in any type of real estate market, compound appraisal-based formulas are most often used in expensive markets where the original Homebuyer’s Base Price is likely to be greater than the original appraised value of the Home (improvements only). In other words, the available subsidy will cover only a part of the market value of the land, leaving the Homebuyer paying a Base Price that must cover all of the value of the improvements plus part of the value of the land.

This type of expensive real estate market also calls for a way of defining the purchase option price that is different from the way it is defined in Versions 1 and 2. In Section 10.9 of Version 3, the Purchase Option Price is defined as the lesser of the Formula Price or the appraised value of “Homeowner’s Ownership Interest,” rather than the lesser of Formula Price or the appraised value of the Home (improvements only), as in Versions 1 and 2, since the latter approach could result in a Purchase Option Price that is less than the original Base Price even in an appreciating market (because the value of the improvements represents only part of the value that the Base Price covered).

Note that the approach taken in this version to defining the Purchase Option Price is *fair* even if the Base Price is *less than* the original appraised value. However, this approach becomes *necessary* (to avoid *unfairness*) in any situation where the Base Price is *greater* than the original appraised value. Therefore, if a CLT does not know whether its base prices will be greater than original appraised values but has reason to believe that base prices *could* be greater than original appraised values in some circumstances, it should define the Purchase Option Price as the lesser of the Homeowner’s Ownership Interest or the formula price. However, in defining the formula price, it may still choose to use an indexed or fixed-rate approach (as in version 4 below) rather than the compound appraisal-based formula used here in version 3.

### **Section 10.5 Appraisal**

Because all resale price calculations in this version (in both sections 10.9 and 10.10 start with the value of the entire property rather than the value of the improvements only, the appraisal called for here does not require separate valuation of land and improvements.

**10.9 Purchase Option Price as Lesser of Appraised Value of Homeowner’s Ownership Interest or Formula Price**

Because the concept of “Homeowner’s Ownership Interest” is essential to both sections 10.9 and 10.10 it is identified here in section 10.9 only through reference to section 10.10.

**Section 10.10 Calculation of Formula Price**

The logic of compound appraisal based formulas is simple: the Homeowner is allotted a portion of the appreciated value of that part of the total value that Homeowner has paid for. However, the calculations required to apply the formula can be confusing and can result in errors if care is not taken. Some CLTs have therefore included in the lease a form such as the following:

1	Homeowner’s Base Price, as stated above.	\$
2	Initial Appraised Value, as stated above.	\$
3	Ratio of Homeowner’s Base Price to Initial Appraised Value, as stated above (equal to line1 divided by line 2).	___.__%
4	Appraised Value at Time of Resale: Determined in accordance with Section 10.5 above.	\$
5	Total Appreciated Value: Subtract line 2 from line 4.	\$
6	Portion of Appreciated Value to be shared: Multiply line 5 by line 3.	\$
7	Homeowner’s Share of Appreciated Value: Multiply line 6 by 25%	\$
8	Resale Formula Price: Add lines 1 and 7.	\$

Whether such a table is actually included in the lease, or not, it can be duplicated in the form of a live spreadsheet that can be used in doing actual calculations at the time of resale – and perhaps also in presenting sample calculations in the course of orienting CLT homebuyers.

**VERSION 4**

In which:

- a) The Homeowner does *not* have an absolute right to select a buyer.
- b) An “indexed” formula is used (with 3 different “indexes” described in three alternative versions of section 10.10).
- c) The original Base Price *is* greater than the original appraised value of the Home.

In Version 4, the section that appears as “10.5 Appraisal” in Versions 1, 2, and 3 is omitted, since the formulas used in this version are not appraisal-based. An appraisal is not needed to determine the purchase option price, except in certain circumstances as noted below. (The buyer’s mortgage lender will still want an appraisal, but for a different reason.)

**10.8 Purchase Option Price as Lesser of Appraised Value of Homeowner’s Ownership Interest or Formula Price**

Version 4 is like Version 3 in that the Purchase Option Price is defined as the lesser of the Formula Price or the appraised value of “Homeowner’s Ownership Interest,” rather than the lesser of Formula Price or the appraised value of the Home (improvements alone). Unlike Version 3, however, Version 4 does not use a compound appraisal-based formula. So the

value of “Homeowner’s Ownership Interest,” cannot be established through reference to section 10.10, and is calculated instead within section 10.9.

As noted in the commentary on Version 3 above, the definition of the Purchase Option Price in terms of the “Homeowner’s Ownership Interest” is *necessary* (to avoid *unfairness*) whenever a CLT’s base prices *could* be greater than original appraised values in some circumstances.

### **10.9 How the Value of Homeowner’s Ownership Interest Is Determined**

Version 4 does not provide for an appraisal *unless* the CLT believes that the value of the Homeowner’s Ownership Interest is less than the Formula Price. If the CLT does believe that this may be the case, the first paragraph of section 10.9 gives the CLT the option of commissioning an appraisal of the combined value of the Land and improvements in order to calculate the value of the Homeowner’s Ownership Interest.

It should be noted that, although an appraisal may not be required to establish the resale price when the Homeowner intends to sell, it *is* necessary to establish the Initial Value through an appraisal when the Homeowner purchases the Home, and to enter this amount (together with the Base Price and the ratio of the Base Price to Initial Value) in the second paragraph of this Section 10.9. The appraisal required by the Homeowner’s mortgage lender may be used as the basis for establishing the Initial Value. An appraiser who is determining the value of the leasehold estate as collateral for a leasehold mortgage must first determine the value of the entire property (before then breaking out the separate values of the leased fee and leasehold interest), so the Initial Value can be drawn from such an appraiser’s report, but it is again important to note that this amount is not the same as the value of the leasehold estate, which is the lender’s ultimate concern.

### **Section 10.10 Calculation of Formula Price**

Three different formulas are presented in the three variations of this 10.10 – a formula using a CPI index, a formula using area median income as an index, and a formula that increase the purchase option price by a fixed rate of “interest.” Although the last of these does not involve an index, it is like the indexed formulas in that it applies a single factor to the original Base Price to determine the purchase option price, and it affects the other sections of this article in the same ways as the indexed formulas do.

See Chapter 12, “Resale Formula Design,” regarding the considerations involved in choosing an indexed formula.

## **ARTICLE 11: Reserved**

In previous versions of the Model, this article dealt with assignment of the lease and subleasing. In the current version, (a) assignment is no longer permitted under section 10.11, which now calls for a new lease whenever the Home is sold, and (b) the subject of subleasing is dealt with in Section 4.5, immediately following the occupancy provisions in Section 4.4. We have retained Article 11 as “Reserved” for whatever additional provisions a CLT may wish to include, rather than allowing the numbering of articles in this version to differ from that in previous versions.

## **ARTICLE 12: Default**

If an action or omission of the Homeowner rises to the level of a defined event of default, then the remedies available to the CLT will force the homeowner to give up the home. For

this reason, this Model builds in fairly generous rights to cure violations by the Homeowner.

### **Section 12.1 Monetary Default by Homeowner**

Earlier versions of the Model provided for notification to Permitted Mortgagees regarding a lease violation only after the expiration of an initial 30-day “grace period” during which the Homeowner had a right to cure the violation. There was then an additional 30-day period during which the Permitted Mortgagees could cure the default. However, a good deal of confusion resulted when a mortgage lender required that it receive copies of *all* “notices of default” under the Lease and have an immediate right to cure such defaults. More recent versions of the Model take the simpler approach of requiring that a notice of Homeowner’s violation of the Lease be sent to any Permitted Mortgagee at any time such notice is sent to the Homeowner (see PERMITTED MORTGAGES, section B(6)). This Section 12.1 then provides for a 30-day cure period during which *either* Homeowner or Mortgagee may cure the violation.

### **Section 12.2 Non-Monetary Default by Homeowner**

Considerations involving protection for both Homeowner and CLT are approximately the same for non-monetary violations as for monetary violations. Note, however, that the Model provides for a longer cure period in the case of non-monetary violations, since violations of non-monetary provisions may be more complicated and time-consuming to correct.

As discussed in Chapter 20, “Financing CLT Homes,” mortgagees may have particular concerns with the possibility of non-monetary defaults, since it will normally be impossible for the mortgagee to cure such defaults (e.g. a violation of the owner-occupancy requirement). Some national financial institutions have therefore insisted that a lease rider eliminate such a possibility during the life of the mortgage in question. (However, the Fannie Mae “Uniform Rider” does allow defaults relating to the two non-monetary requirements of greatest concern to CLTs: resale restrictions and owner-occupancy requirements.)

In order to address mortgagees’ concerns with non-monetary defaults, Some CLTs have provided for substantial fines for non-monetary violations. A failure to pay such fines becomes a monetary default, which a mortgagee has the ability to cure. Any such fines for major violations, such as unauthorized subleasing, must be heavy enough so that it will not be in the homeowner’s interest to just pay the fine and continue the violation.

### **12.4 CLT’s Remedies: Termination or Exercise of Purchase Option**

The provisions for termination of the lease and eviction of the homeowner (Section 12.4-a) have been a standard part of all versions of the Model Lease and the CLT leases based on the Model. Such provisions have rarely – if ever – been fully implemented and carried through to actual termination and eviction, but their presence in the Lease provides important leverage for any CLT that must deal with a serious violation. The language in this 2011 version has been modified to make it clear that, upon termination of the lease, the CLT’s right to enter and reposes the Home and evict the Homeowner is subject to whatever due process is established by applicable law. No CLT should attempt to follow through with termination and eviction without the involvement of an attorney who is familiar with the law affecting that process.

The provision for exercise of the purchase option (Section 12.4-b) has been added to the 2011 version of the Model and is based on language used by some California CLTs. Its enforceability may vary from one jurisdiction to another. Some CLTs may choose not to include it in their lease. Those that do wish to include it should consult with their attorneys

regarding its enforceability and potential consequences. When it can be exercised, however, it can be an easier, friendlier remedy than termination and eviction.

It is also important to note that some potential mortgagees have insisted on lease riders that disallow lease termination (as in section 12.4-a ) as a remedy for violations of nonmonetary lease provisions. Most mortgagees, however, do not have a problem with the “purchase option remedy” provided by 12.4-b. (See the discussion of nonmonetary lease defaults in Chapter 25, “Dealing with Worst Cases.”)

### **12.5 Default by CLT**

The CLT does not want to be too quickly subject to being in default if the Homeowner is looking for a “technicality” to which to object. On the other hand, the CLT does have certain important responsibilities under the Lease , and the Homeowner should not be hurt by too long a failure of the CLT to perform its obligations. The time period in this section is again a suggested reasonable compromise.

## **ARTICLE 13: Mediation and Arbitration**

Previous versions of the Model Lease have not provided for mediation but have called for a specific arbitration process, as follows.

*13.1 ARBITRATION PROCESS: Should any grievance or dispute arise between Lessor and Lessee concerning the terms of this Lease which cannot be resolved by normal interaction, the following arbitration procedure shall be used.*

*Lessor or Lessee shall give written notice to the other of its selection of a disinterested arbitrator. Within fifteen (15) days of the receipt of this written notice, the other party may give written notice to the first party appointing a disinterested arbitrator of its own choice. These two arbitrators shall select a third arbitrator. If the other party fails to name an arbitrator within fifteen days of receiving the notice from the first party, the arbitrator selected by the first party shall be the sole arbitrator.*

*The arbitrator or arbitrators shall hold a hearing within thirty (30) days after the initial written notice by the initiator of the arbitration process. At the hearing Lessor and Lessee shall have an opportunity to present evidence and question witnesses in the presence of each other. As soon as reasonably possible, and in no event later than fifteen days after the hearing, the arbitration panel shall make a written report to the Lessor and Lessee of its findings and decisions, including a personal statement by each arbitrator of his/her decision and the reasons for it. The arbitrators shall decide the dispute or claim in accordance with the substantive law of the jurisdiction and what is just and equitable under the circumstances. The decisions and awards of the majority of the arbitration panel shall be binding and final.*

Some CLTs have provided for mediation as a first step, but have then provided for arbitration if either party is not satisfied with the results of mediation – with the arbitration process described more or less as stated above.

It is important to note that the effect of an arbitration provision in a lease will vary from state to state. Some states (e.g., California) have very detailed statutes concerning arbitration clauses and the effect a court must give to an arbitration award. Other states do not have such a statute, but typically judicial decisions will try to give an arbitration requirement the effect

of making an attempt at arbitration a prerequisite to a lawsuit.

In the 2011 version of the Model Lease, the more specific arbitration *requirement* has been replaced with a broad statement of what is *permitted* (any form of mediation or arbitration that the parties agree to pursue). The reasons for the change are (1) the variations in the legal treatment of arbitration from state to state, and (2) the fact that an arbitration process can be as time-consuming and expensive as the court process it is intended to replace.

Before a CLT chooses either to adopt the new short version of Article 13 or to include a specific arbitration provision, it would be advised to ask its attorney to determine how the law of the state in question deals with the arbitration process and its effects.

## **ARTICLE 14: General Provisions**

This article contains a number of provisions that do not fit elsewhere in the Lease. In addition to the provisions included in the Model, a CLT may wish to include other provisions, such as those that its attorney finds necessary or useful with regard to specific features of local or state law.

### **Section 14.1 Homeowner's Membership in CLT**

It is the practice of most CLTs for Homeowners to be entitled to CLT membership without having to do anything more. This Section should, of course, be consistent with the bylaws and other organizational documents of the particular CLT (see Chapters 4 & 5 regarding bylaws issues).

### **Section 14.2 Notices**

Notice provisions are often ignored as “boilerplate.” This is unfortunate, as in many states the notice provisions of a lease are strictly interpreted by courts when one party is attempting to terminate the significant property rights of the other party. Timing is important. In an area where mail service is slow, the effective date of a notice could be made two business days after deposit in the mails, or upon actual delivery by hand, whichever is earlier.

### **Section 14.4 Severability and Duration of**

As discussed in Chapter 10, “Legal Issues Re. CLT Ownership,” some question may arise as to whether a particular provision of the Lease violates the Rule Against Perpetuities. Although, as is demonstrated in Chapter 9, “The Enforceability of the CLT’s Preemptive Right,” the Lease should withstand such a challenge, it is prudent to protect against an adverse outcome. Therefore, this “savings” clause is designed to accomplish two goals. First, it contains standard language stating that the invalidation of one provision of the Lease does not invalidate the Lease as a whole. Secondly, it provides “measuring lives” for the purpose of determining the applicable time period under the Rule Against Perpetuities. If a court were to find some “interest” in the Lease to be subject to the Rule, that interest should at a minimum survive for the duration of the measuring lives plus 20 years (or, stretching all the way, 21 years). Given a large group of measuring lives including infants, odds are high that the interest would last the full 99 years of the Lease even in such a worst case legal situation.

Note that some states have taken the approach of the Model Rule Against Perpetuities statutes and exempted all “nondonative” transactions from the common law rule (see, e.g., Mass. Gen. Laws, Ch. 184A, Sec. 1). In those states it would be prudent to specifically refer also to the statutory exemption.

**Section 14.5 Right of First Refusal in Lieu of Option**

In the event that foreclosure of a Permitted Mortgage eliminates the CLT's option to purchase for a restricted price [see Exhibit PERMITTED MORTGAGES, B(7)], the CLT will want an alternative means of "recapturing" the housing. This Section therefore says that if for any reason the purchase option is not available, the CLT still has a "right of first refusal." The price to the CLT in such a situation would of course be established by a third party in an open market situation. (In a foreclosure situation, the CLT may also have an opportunity to buy the home back directly from the mortgagee for the amount owed the mortgagee [see Exhibit PERMITTED MORTGAGES, A(3)] The right of first refusal thus represents a last-resort means of regaining control of the home.

Note that in early versions of the Model this provision of a right of first refusal appeared as the final section of Article 10, following the provisions relating to the purchase option. In later versions it has been moved out of Article 10 so that there will be no possibility of its being wiped out in a foreclosure situation along with the purchase option provisions it is intended to replace as a fall-back measure.

The specific terms of this right of first refusal (as well as the separate right of first refusal established in Section 3.3) are spelled out in Exhibit FIRST REFUSAL.

**Sections 14.6 - 14.11**

These are all standard lease clauses. Section 14.6 is intended to protect the CLT against arguments that its conduct implicitly waived rights that were otherwise explicit in the Lease. Section 14.7 deals with potential challenges to title affecting the Homeowner's occupancy, and obligates the Homeowner to give "all reasonable aid" in such actions. This is a corollary to Section 2.1, in which the Homeowner takes its leasehold without any representations from the CLT and without an obligation of the CLT as lessor to defend title actions. Section 14.8 makes it clear that, in the language of the Lease, no pronouns are intended to be restrictive as to gender or number. Sections 14.9 and 14.11 address different aspects of legal interpretation of the language of the Lease, stating what might be the rule anyway if the clauses were not included. And Section 14.10 in several ways points out that the Lease is a document that is intended to stand on its own and govern the CLT-Homeowner relationship notwithstanding discussions to the contrary and changes in the parties unless the parties go through the formality of a written amendment of the Lease. The effectiveness of such provisions will vary from jurisdiction to jurisdiction.

**Section 14.12 Recording**

In many states, the recording of a lease or some notice that the lease exists is essential for the rights of the Homeowner to be protected against the rights of the holder of a mortgage on the fee interest in the land. For example, Mass. Gen. Laws, Ch. 183., Sec. 4. provides that any lease for greater than 7 years must be recorded, or a notice thereof must be recorded, in the appropriate registry of deeds or the leasehold interest is subject to foreclosure by a mortgagee, even one with a mortgage recorded subsequent to the date of such unrecorded lease. In the CLT context, if the CLT were to obtain financing (including subsidies structured as deferred loans to the CLT) secured by a mortgage of its fee interest in the land, and that lender were to foreclose, the lease might be "wiped out" if there were not recorded notice of its existence. There are other doctrines of actual notice which might protect the Homeowner, but the safest method is for there to be a recorded notice of the Lease.

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<sup>1</sup> Mass. Gen. Laws, Ch. 59, Sec. 59.

## Chapter 12

# Resale Formula Design

### Introduction

A CLT resale formula establishes an upper limit on the price for which a CLT home may be resold – whether it is sold back to the CLT or sold directly to another household. Once a CLT adopts such a formula, the usual expectation is that it will be written into all of the organization’s ground leases and applied consistently to all of the organization’s homes each time each home is sold. Classic CLT bylaws (following the model presented in Chapter 5A) require an elaborate process to change the resale formula, involving supermajority votes by both the membership and board of directors. Clearly the process of designing a formula that will have such long-term consequences is one of the most important and difficult tasks that a new CLT must undertake. Whatever formula is adopted will affect the specific rights and obligations of both the CLT and its many homeowners for generations to come.

Chapter 8, “Implementing Restrictions on Ownership,” discusses the rationale for resale restrictions in general, as well as the CLT’s method of implementing these restrictions through a ground lease. Chapter 9 discusses the legal enforceability of the CLT’s preemptive right to repurchase a homeowner’s home for a price determined by the resale formula established in the CLT ground lease. The purpose of the present chapter is to help new CLTs work through the many issues involved in designing their own formulas in accordance with their own purposes, preferences, and circumstances.

The chapter focuses on formulas designed to regulate the resale price of single, owner-occupied housing units – whether free-standing single-family homes, townhouses, or condominium units. Many, but not all, of the factors discussed will also apply to formulas designed for other types of CLT lessees, including housing co-ops (see Chapters 15-A and 15-B), and nonprofit service providers and businesses of various sorts (See Chapter 16, “Non-Residential Ground Leases”). CLTs that anticipate leasing land to such entities may develop specialized formulas based on their specific goals and practical concerns.

**Equity and Appreciation.** A homeowner’s equity is the value of the home *minus any debt* that encumbers the home – in other words, the amount of money that an owner can expect to receive upon the sale of the home after all debt secured by mortgages or other liens has been paid off. In the case of a just-purchased home, the owner’s equity normally equals the amount of the down-payment, which is typically a small percentage of the total purchase price. As the owner makes monthly mortgage payments, her equity will increase (slowly at first, when payments consist mainly of interest; then more rapidly as an increasing portion of each payment is applied to principal).

In an unrestricted market situation, the owner’s equity will also increase with any appreciation of the market value of the home. In fact, when a person buys a home by making a relatively small, down-payment and borrowing the balance of the cost, market appreciation can cause that person’s equity to increase many-fold in a short period of time. For example, if a home is purchased with a 5% down-payment and appreciates by 5% in the first year (and if the owner is able to capture all of this appreciation), the equity that the owner purchased through the down-payment will increase in that year by 100%. This “leverage” – whereby an

up-front investment of only a portion of the total value allows the investor to capture 100% of any appreciation of that total value – is an important consideration for real estate investors.

In limiting the resale price, a CLT resale formula limits the amount of market appreciation that can be claimed by the owner as equity. In practice, the terms “limited equity formula” and “limited appreciation formula” have sometimes been used interchangeably with the term “resale formula.”

**Theoretical Basis for Allocating Appreciation.** Appreciation in the value of real estate can be caused by two basic factors. One source of appreciation is the dollars, materials, and labor that the owner invests in the home over time to develop or improve it. The other source is a set of social and economic factors that are beyond the control of the individual property owner – factors that can include changes in the level of private investment in the surrounding neighborhood; public investment in streets, sidewalks, streetlights, parks, schools; changes in transportation patterns, employment trends, or population in the surrounding region; changes in tax policies or land-use regulations, among many other factors that affect home prices.

To the extent that other practical considerations allow, CLTs try to allocate appreciated value fairly – to its true source. In other words, as far as possible, *value produced or purchased by the homeowner should be allocated to the homeowner and should add to the owner’s equity. Value produced by other social and economic factors should be “retained by the CLT”* (in the form of a reduction in the resale price that will make the home more affordable for lower income residents of the community).

It should be emphasized that CLT resale formulas do not *guarantee* that a homeowner will receive all of the value that she would ideally be entitled to, or even all of the value that the resale formula would allow, just as the market does not guarantee this kind of return to conventional homeowners. The CLT’s option to purchase the home for a limited price (the “purchase option price”) is usually an option to purchase for a price that is the *lesser* of the price determined by the resale formula *or* the appraised value of the home at the time of resale (see Model Ground Lease, Section 10.8 – 10.10, depending on which version of Article 10 is used). Though a successful CLT may help to stabilize real estate prices in a community – and thereby help to maintain the market value of homes – it cannot promise that a home’s market value will not be eroded by social, political, or market forces beyond the control of both the homeowner and the CLT. CLTs do not normally have the resources that would allow them to repurchase homes for prices higher than what they can expect to resell them for.

### **Goals in Designing a Formula**

For all CLTs the primary goals in designing a CLT resale formula are (1) to ensure *fair access* to homeownership for subsequent lower income residents by preserving the affordability of the CLT home, and (2) to give the present homeowner a *fair return* on her investment when she resells her CLT home.

These goals are not mutually exclusive, but there is clearly a tension between them. Formulas that are most certain to give the outgoing homeowner a fair return are likely to run a higher risk of eroding the home’s affordability for future homebuyers. Formulas that are most certain to preserve affordability run the risk of preventing a “fair” return. Each CLT must decide for itself what is fair and what is likely to preserve affordability, and must then design a formula in which these two essential concerns are reasonably balanced. In doing so, the CLT must also consider a number of important secondary goals. Different CLTs will assign

different priorities to these secondary goals, but all should consider the full range of practical issues they raise. Possible secondary goals include the following.

- *Encouragement of long-term occupancy, avoidance of incentives for quick resale.* CLTs have a basic interest in promoting stable neighborhoods and in providing long-term security for residents of these neighborhoods. They do not intend to provide homeownership opportunities as a way for owners to turn a quick profit and make a fast exit.
- *Promotion of homeowner mobility.* When CLT homeowners wish to sell their homes – perhaps to take advantage of employment opportunities in another community – they have an interest in selling for a price high enough to allow them to purchase a home in their new community. Some people argue that, if a CLT is to provide permanent benefits for lower income people in an increasingly mobile society, it should allow resale prices high enough to allow continued homeownership for those who move away. Others, however, see this goal as inconsistent with the CLT’s concern with long-term occupancy and neighborhood stability, or may see it as impractical in light of the primary goal of preserving the affordability of CLT homes.<sup>1</sup>
- *Incentives for sound maintenance.* CLTs do not want their resale formulas to pose economic disincentives to sound maintenance of the home. A formula that fails to reward an owner’s investment in such maintenance – or fails to penalize poor maintenance – can increase the likelihood that the homes will deteriorate and that their future usefulness will erode.
- *Incentives for useful improvements.* In some situations, CLTs have reason to encourage owners to make useful improvements in their homes, and perhaps make other improvements on the leased land. Rural CLTs may want to encourage ecologically appropriate improvement of the land itself. Many CLTs want to encourage weatherization and other energy-saving improvements of existing homes. Some may want to encourage the expansion of smaller homes to accommodate larger families. In some urban situations, however, a CLT may decide that small residential lots are already used to the optimum and may not want to encourage substantial additions to existing homes. (A few CLTs have chosen not to reward – or even permit – improvements because they want homeowners to *move out* of their “starter homes” when their fortunes increase, making room for the next lower-income, first-time homebuyer.)
- *Ease of comprehension by those affected.* In an effort to allocate equity with perfect fairness, a CLT can develop a formula so complicated that it will be incomprehensible to potential or actual CLT homeowners – and perhaps to everyone except its creators. At some point it must be recognized that a formula that allocates value less precisely to its source but that is readily comprehensible may be preferable to one that is more intricately precise but less comprehensible.
- *Ease of administration.* Formulas that require extensive record-keeping and/or frequent, detailed assessments of the value of improvements to the home may be very fair in theory, but they may also be beyond the capacity of a CLT with limited staff to administer, accurately and consistently, for many homes over many years. Ease of monitoring, record-keeping, and documentation are important concerns.

- *Lack of intrusiveness; sense of ownership.* It is important that owners of resale-restricted homes feel that they are “real” owners, with a sense of privacy and control over their homes comparable to that of conventional homeowners. A formula that requires frequent inspections and prior approval of repairs and improvements can undermine this sense of ownership.
- *Avoidance of disputes.* All resale formulas involve a tension between the interests of the homeowner and the interests of the CLT and community. Disputes can easily arise from this tension, but occasions for dispute can be minimized to the extent that the formula does not require subjective, debatable judgements on the part of CLT personnel in order to determine the resale price.

Given these various and important concerns, it should be clear that there is no one perfect resale formula. A number of trade-offs – among potentially conflicting social goals, economic interests, and practical concerns – must be made in designing a formula. The process of deciding on these trade-offs involves hard, complicated choices, defining the rights and responsibilities of many people. A CLT that tries to avoid or minimize the difficulties of the process is likely to sow the seeds of future confusion and dispute. The process of designing a resale formula should be inclusive and deliberate. It cannot be hurried.

### **Base Price, Equity Build-Up, and Adjustments**

**Defining the base price.** Almost all CLT resale formulas begin by stating a “base price,” which the formula then adjusts by one method or another to arrive at the resale price. (The only type of formula that does *not* start with a base price is the rarely used and not recommended “mortgage-based” formula that is described below.)

The base price is the amount that the buyer actually pays for the home, including both the amount of the buyer’s down payment and the amount of the repayable first mortgage loan that the buyer receives. It is the amount that can usually be called simply the “purchase price,” but for our present purposes we will avoid that term because we want to avoid the confusion that results in those cases where what is called the “purchase price” for certain formal purposes actually includes not only the amount that the buyer herself pays but also some amount of subsidy that is treated as a deferred loan to the buyer. In referring to such cases we will use the term “settlement price” in order to be clear that the settlement price is *not* the base price – and therefore not the base on which a resale formula should rest.

As is emphasized in Chapter 19, “Subsidy Structure,” the relationship between *price* and *subsidy* can be structured in two quite different ways. If the subsidy is committed directly and permanently to the CLT, it will directly and permanently reduce the price of the home for all homebuyers. However if the subsidy is structured as a deferred loan to the homebuyer, the amount of the subsidy will be included in the “settlement price” when, for instance, the price is stated in a “HUD 1 Settlement Statement.” In this case, the subsidy results in a higher settlement price being affordable for a household of a given income because it reduces the household’s monthly mortgage payments, but it does not reduce the settlement price itself. The first of these approaches, which “locks in” the subsidy, is *the* approach taken by CLTs whenever possible. The second approach is a fall-back method used by CLTs only when subsidy cannot be permanently locked in.

If a subsidy source insists on structuring a subsidy in the second way, as a deferred loan to the homebuyer, it is important that the CLT do two things. First, it should make every effort

to see that the deferred loan will be fully assumable by the next homebuyer and is *not* eventually *forgivable* (turned into a grant to the first homeowner). Second, it should structure the resale formula in such a way that the resale price is not inflated by allowing the homeowner to earn a return on the subsidy (deferred loan) as well as on the base price. This can be accomplished by using the term “base price” (not “purchase price”) in stating the resale formula and by defining this term explicitly as consisting of *only* the buyer’s down payment and first mortgage amount.

**Building equity by retiring debt.** Not all of the base price paid by the owner represents owner’s equity until all of that portion of the price that was borrowed by the owner has been repaid. At the time of purchase, the owner’s equity consists of the down-payment, which may occasionally include not only the owner’s cash investment but value contributed as sweat equity prior to the transfer of title. This equity will then increase as debt is retired. The normal assumption is that the amount of monthly equity build-up will be determined by the portion of that month’s mortgage payment that is credited to principal (a small portion at first, when most of the payment goes to cover interest; a larger and larger portion as debt is retired). However, a simple application of this assumption may undermine affordability for subsequent owners in cases where interest has been subsidized in order to increase affordability for an initial owner.

High interest rates can be a major barrier to homeownership for lower-income people. This barrier may be reduced by below-market-rate mortgage financing for a family purchasing a CLT home. The “interest subsidy” represented by the lower rate will allow the family’s monthly mortgage payments to be lower. It will also mean that a smaller portion of each monthly payment consists of interest, with a larger portion going to retire principal.

In such cases, CLTs must decide what portion of the retired debt should be credited to the purchaser as equity. If all repaid principal is credited as equity, the household with subsidized interest will build up equity faster than households paying the same monthly amount on mortgages at higher interest rates. The accelerated equity build-up raises both a question of fairness and a question of future affordability. If a household whose mortgage interest is subsidized is able to accumulate substantial equity through monthly payments of principal and then sells the home for at least the original price, the value of the interest subsidy will be removed – “privatized” – by the seller (except in the case of affordable loan programs like the USDA 502 direct loan program that have provisions for recapturing interest subsidy upon the sale of the home). If the CLT relies on interest subsidy to make a certain purchase price affordable for a homebuyer who could not otherwise afford that price, and if the interest subsidy is then captured by that homeowner, then the CLT will need to arrange another equally low-interest loan (additional interest subsidy) if the home is to be equally affordable for the next purchaser at that income level. Any CLT that relies on interest subsidy (or other forms of homebuyer-by-homebuyer subsidy) to make a home affordable, rather than establishing an affordable base price, is likely to face affordability problems in the future – unless the issue is addressed in the design of the resale formula.

Some CLTs address the problem by not crediting the full amount of debt retired in such situations as equity build-up. Instead, they establish a standard minimum interest rate (normally at or close to market rate), which is used to calculate the amount of interest the homeowner *would have* paid without the subsidy, which then allows a calculation of the amount of interest subsidy received during the time in question. This amount is then

subtracted from the resale price, so that the value of the subsidy is passed on directly to the next buyer.<sup>2</sup>

**Adjusting the base price to determine the resale price.** Most of the questions that a CLT must address in designing a resale formula have to do with the way that the base price will be adjusted upward (or possibly downward) to arrive at the resale price. It is in deciding on the *method* for making these adjustments that the CLT must balance its two primary goals of fairness and affordability, while also taking into account its secondary goals.

In the next section of this chapter we will describe two methods that are quite rare among today's CLTs and that are generally not recommended, but that are useful to examine because they entail relatively direct, uncompromising efforts to achieve one or the other of the primary goals – to be as fair as possible in the case of “itemized formulas,” and to ensure that affordability is preserved in all circumstances in the case of “mortgage-based” formulas. After reviewing these “theoretically pure” approaches, we will discuss the more commonly used types of formulas, which might be described as occupying the middle ground between the theoretically pure approaches.

### **Itemized and Mortgage-Based Formulas, Pure in Theory but Not Practical**

**Itemized Formulas.** Itemized formulas determine the resale price by adding to or subtracting from the base price specific factors that increase or decrease the value of the homeowner's investment in the home. These formulas were relatively common among early CLTs but have generally been abandoned, even by those that initially adopted them. Nonetheless, it is important to understand how such formulas work, because they illustrate issues involved in efforts to base the homeowner's equity gain on a direct measurement of her actual investment over time, and because elements of these formulas find their ways into some more commonly used types of formulas.

Itemized formulas can vary widely in the factors that they itemize and in the ways that they deal with these factors. The factors (or “items”) more commonly considered for inclusion are discussed here.

*Value of Improvements.* Value added to a home through improvements made or paid for by the owner can be treated as additions to the resale price. The measurement of this value represents one of the most important – and most difficult – features of this type of formula. It is difficult because calculating the value of homeowner-initiated improvements depends on distinctions and decisions that are not easily made. Four types of difficulty should be noted.

One difficulty is the distinction between *replacements or repairs*, which are necessary to retain or restore the original value of the home, and *improvements*, which add value beyond the original value. This distinction is simple in principle but often complicated in practice. A huge variety of possible alterations must be classified as either repairs or improvements – and many are actually both. The replacement of a deteriorated single-pane window with a double pane, energy-efficient window is both a replacement and an improvement, as is the installation of a new roof in place of a roof that is now badly deteriorated but that was already half-way through its expected lifetime when the owner bought the home. Efforts to take all such circumstances into consideration when assigning value to an owner's improvements can be extremely complicated.

A second difficulty is the distinction between improvements that increase the *utility* of the home in an appropriate way (e.g., addition of a bedroom) and those that may be considered

unnecessary *luxuries* and that may increase the purchase option price beyond the reach of lower income homebuyers. Should an owner be credited with equity for the value of a swimming pool installed in the backyard, or (to note an extreme example) the value of a marble bathtub with gold faucets? CLTs that have used resale formulas with improvement factors have usually tried to exclude such luxuries from the type of improvements that would be allowed to increase the resale price of the home; nonetheless, defining exactly what is and is not a luxury is not easy.

A third difficulty is the question of *how improvements are actually to be valued*. Should the value be determined by what goes into the improvement (the owner's investment in materials and labor) or what comes out of the improvement (the resulting change in the market value of the home). With the former approach, it is relatively easy to determine the dollar value of the owner's investment if the owner pays a contractor for the full cost of an improvement, but if the owner does some or all of the work herself, or gets a friend to help her, how is the value of the labor to be assessed? The skill and productivity of do-it-yourselfers vary tremendously. But even if the dollar value of the investment can be measured exactly, it does not follow that the market value of the home is correspondingly increased. Resulting changes in market value can be calculated – with some approximation of accuracy – by professional appraisers, but the time and cost entailed in commissioning an appraisal for a specific improvement is substantial.

A fourth difficulty derives from the three factors discussed above. This difficulty is the *potentially contentious process* of approving and valuing improvements that will affect the resale price.

It should be noted that other types of formulas – including the common appraisal-based, fixed-rate and indexed formulas discussed in the next section – can also entail improvement factors, though usually these are limited to major, appraisable improvements, such as the construction of a garage or additional bedroom.

*Maintenance, Repairs, and Depreciation.* An itemized formula would not normally add the value of maintenance and repairs to the resale price unless it also subtracted a certain amount for depreciation. In general, value added through maintenance and repairs should roughly compensate for equal value lost through depreciation, so it is possible not to account for either factor in an itemized formula on the assumption that the two cancel each other out.

*Penalties for Unusual Damage.* Regardless of whether an itemized formula includes a standardized depreciation factor, it may provide a separate direct penalty to cover the cost of extreme damage to the home caused by the owner. Such penalties (which are sometimes added to other types of formulas as well) can provide important protection for the CLT in cases of outright destructiveness or irresponsibility by an owner. Because such a penalty can easily lead to a dispute between the CLT and the owner – or aggravate an already bad situation – it is especially important that very clear procedures be established for assessing the damage and imposing the penalty.

*Inflation Adjustments.* Itemized formulas can also include inflation factors. Monetary inflation – characterized by increased prices of goods and services generally, and therefore by reduced purchasing power of a dollar – can have a major effect on the value of any long-term investment. The common method of compensating for the effect of inflation is to increase the dollar amount of the owner's equity in proportion to an increase in one of the Consumer Price Indexes maintained by the federal Department of Labor – most often the Consumer Price

Index for Wage Earners for the region or metropolitan area in question. When the goal is just to adjust for inflation the value of what the homeowner has “earned,” the inflation factor is applied only to the equity that the homeowner has accumulated over a given period of time. This is a very different practice – with very different results – from the practice entailed by “indexed formulas,” which, as explained later in this chapter, apply the index to the base price rather than to the owner’s equity.

#### *Advantages of Itemized Formulas*

- An “improvements factor” can give owners a direct means of recapturing the value that they add to their homes through improvements.
- An inflation adjustment can prevent the devaluation of the owner’s earned equity – while not giving unfair leverage to an owner with a small amount of equity in a property.
- These formulas can be tailored to encourage and reward improvements that are useful to future, as well as current, residents.
- These formulas insulate resale prices from the fluctuations and speculative pressures of the housing market and the broader economy.

#### *Disadvantages of Itemized Formulas*

- These formulas can require difficult assessments of the value of improvements, particularly where the CLT must enforce fine distinctions between repairs and improvements, between luxury improvements and useful improvements, and between improvements that are properly done and those that are not.
- Accurate application of inflation adjustments to owner’s equity can be fussy and time-consuming. If the inflation factor is to be compounded annually, the CLT must calculate the total amount of equity held from year to year, based on mortgage debt repayment as well as on the other factors introduced by the formula.
- Administration of these formulas makes very burdensome demands on limited CLT staff time. Extensive record-keeping and relatively complex periodic calculations are required, which can strain the CLT’s administrative capacity to the limit – or can result in essential tasks being improperly done or left undone.
- The necessary judgments, calculations, and record-keeping can result in serious misunderstandings and disputes between CLT and homeowners.
- The CLT’s ongoing role in determining what improvements will be allowed to add to the owner’s equity and in assessing the value of these improvements can diminish the owner’s sense of privacy and ownership.

**Mortgage-based formulas.** The more commonly used resale formulas aim at preserving affordability by limiting the price for which a home can be resold. However, they do not limit the interest rates that will also affect the affordability of the next buyer’s monthly mortgage payment. An increase in these rates can undermine affordability. Mortgage-based formulas are the only formulas that directly address this problem. They establish the resale price not in terms of adjustments applied to a base price but in terms of the amount of mortgage financing a purchaser of a given income level will be able to afford at the then-current interest rate. By thus assuring affordable mortgage payments for the next buyer, however, they create potentially serious problems for the homeowner who must sell in a time of increased interest

rates. For this reason they are rarely used. Nonetheless, it is useful to understand how they work.

*Components of mortgage-based formulas.* The designer of a mortgage-based formula must specify the following factors:

- The income level (as a percentage of area median income adjusted for a particular household size) for which affordable monthly payments are to be calculated.
- The components of the monthly housing cost to be considered in calculating affordability (the usual components being principal, interest, taxes, insurance and lease fee).
- The percentage of gross income that will be considered an “affordable” allocation for the monthly housing costs in question (stated either as a fixed percentage, e.g. 30%, or as the maximum percentage allowed at the time of resale by applicable home mortgage programs).
- The percentage of the resale price that is to be covered by mortgage financing (usually at least 95%).
- The type of mortgage (usually 30-year fixed-rate) for which monthly payments are to be calculated at the “current interest rate.”
- The index or benchmark that will be used to determine the exact “current interest rate” for the type of mortgage in question for the time in question.

*Method of calculation.* It should be emphasized that when the resale price is established at exactly the amount that is “affordable” (i.e., the maximum amount “affordable”) for a given income level, the price will be “unaffordable” for any household with a lower income. This means that if the goal is to maintain affordability for households *below* 80% of AMI, the formula cannot establish the price at what is (just barely) affordable for households *at* 80% of AMI. To achieve such a goal, the formula must establish the price at what is affordable for some significantly lower percentage of AMI, say 60%. If a specific mortgage-based formula is designed to keep monthly payments affordable for, say, a four-person household with an income that is 60% of area median income, then the resale price would be calculated as follows.

1. The income, in dollars, for a 4-person household at 60% of AMI would be determined from the figures calculated and published by HUD for the MSA or county for the year in question. (For the purpose of illustration, let us say this amount is \$30,000 per year, or \$2500 per month.)
2. The amount that can be allocated affordably to housing costs each month is determined. (If the percentage used is 30%, then 30% of \$2500 gives us \$750 that can be applied to monthly housing costs.)
3. The portion of this monthly amount that can be used to service debt is determined by subtracting the amounts that must cover other costs. (If taxes for the year in question are \$150 per month, insurance is \$35 per month, and lease fee is \$50 per month, for a monthly total of \$235, then \$515 per month remains available for debt service.)
4. The “current interest rate” is determined. (Say 6.5% for a 30-year fixed rate mortgage)
5. The amount of debt that can be serviced on these terms is determined through an amortization calculation. (The monthly amount of \$515 will amortize a mortgage of \$81,487 in 30 years at 6.5%)

6. The resale price is determined on the assumption that the mortgage amount is a specified percentage of the total price. (If the \$81,487 mortgage is 95% of the price, the price will be \$85,776.)

***Advantages of Mortgage-Based Formulas.***

- This is the only type of formula that can guarantee a given level of affordability upon resale to a household of a given income level, no matter what happens to interest rates – or to property tax rates or other monthly housing costs.
- The basic principle behind this kind of formula – to make sure that each successive buyer has monthly housing costs at the same level of affordability – is easy to grasp for public officials, mortgage lenders, and others directly involved in the buying and selling of homes.

***Disadvantages of Mortgage-Based Formulas.***

- Because these formulas base the resale price entirely on what works for the *buyer*, the price will have no necessary relationship to either the original base price or further investment in improvements by the owner; therefore, these formulas are much less likely than the other types of formulas to give the *seller* a fair return – and may easily give a return that is dramatically unfair. For instance, suppose the seller is someone who had purchased a home, as described in the example above, for \$85,776, at a time when mortgage interest rates were at 6.5%. Suppose the home is then resold a few years later at a time when 60% of AMI for a 4-person household has increased by 5% to a monthly amount of \$2625 – 30% of which would be \$787.50 available for monthly housing costs. If the cost of taxes and insurance had also increased 5% and the lease fee had remained the same, then \$543.25 would be available for monthly mortgage payments. Now suppose that mortgage interest rates have risen to 8.5%. At this rate, a buyer with an income at 60% of AMI can afford a mortgage of only \$70,644, which, with a 5% down payment, would mean a resale price of \$74,362. For the seller who had paid \$85,776 the result would be a loss of \$11,414, even if the home had been improved and had increased in market value. In effect, one lower-income household would be required to provide a substantial subsidy to another. The effect on the former owner is potentially disastrous. Conversely, if interest rates had dropped substantially, the seller could receive a windfall profit, even if the home was unimproved and poorly maintained.
- The fact that these formulas determine resale prices based on factors over which the seller has no control tends to distort the process by which an owner decides whether to sell and when to sell. If interest rates are high the owner may try to hang on until rates go down. Such an owner may be tempted to violate (or perhaps only nominally comply with) the CLT's restrictions on absentee ownership and subletting. In any case such an owner's mobility is diminished.
- Mortgage lenders have reason to object to a formula that could result in a resale price lower than the amount owed on the mortgage, unless an escape clause is added to protect the lender in such a situation.
- Government affordable housing programs with regulations requiring that resale restrictions allow the seller to receive a "fair return" may not approve this type of formula.

- It may be somewhat difficult to establish a clear index or benchmark as the determinant of the “current interest rate” to be used in calculating resale prices over the long run. Particular indices, as well as particular mortgage products, may come and go and change over time.
- Though the principle may be easy to grasp, homeowners are unlikely to be familiar with the specific calculations required to determine resale prices – adding to the owner’s sense of uncertainty.

Clearly the disadvantages of such formulas must be seen as prohibitive if implemented in the manner described here. For those willing to accept yet another level of complication, it is possible to mitigate the most serious disadvantages by establishing upper and/or lower limits beyond which interest rate fluctuations will not be permitted to push resale prices. One way to set a minimum price would be to establish the resale price as the greater of the original base price or the mortgage-based price. However, this approach would not prevent the price of the home from being ratcheted steeply upward when interest rates dropped. The latter problem could be addressed by a more complicated formula that would establish both a minimum and a maximum price – perhaps by establishing minimum and maximum interest rates to be used in calculating resale prices. Any such adjustments, however, would undermine the mortgage-based formula’s one advantage, its ability to preserve affordability in all circumstances.

### Commonly Used Formulas

The more commonly used resale formulas fall between the extremes of the more theoretically pure itemized and mortgage-based formulas. None of them offers as complete a method of measuring a homeowner’s earned equity as does the itemized formula. None of them offers as certain a method of preserving affordability as does the mortgage-based formula. All of them avoid, or at least moderate, the major practical disadvantages of the theoretically pure approaches, and all are easier to explain and implement. We will review in some detail the three basic types commonly used by CLTs.

- *Appraisal-based formulas*, including three subtypes, all of which adjust the price by allocating to the owner a specified percentage of market appreciation as measured by appraisals at the time of purchase and the time of resale.
- *Fixed-rate formulas*, which allow the price to increase by a fixed annual percentage.
- *Indexed formulas*, which allow the price to increase in proportion to changes in an index such as the Consumer Price Index or the median household income.

**Appraisal-based formulas.** Appraisal-based formulas adjust the resale price by adding to the base price a certain percentage of any increase in appraised market value. Rather than itemizing the factors that can cause increases or decreases in value, these formulas let the market measure changes in value. Any increase in value is then shared between the CLT and the homeowner on a specified basis.<sup>3</sup>

For the purpose of determining how much appreciation has occurred, these formulas establish an original market value that is *not* the base price paid by the homeowner but the appraised value of the homeowner’s property at the time of purchase (with “homeowner’s property” defined differently for different subtypes of appraisal-based formulas). It should be emphasized that we are talking here about appraisals of the market value that CLT homes *would* have *if* their market value were not restricted by the terms of the lease. If the resale formula were to require appraisals that discounted market value because of the restrictions

imposed by the lease, then the resale price of the home would, in effect, be discounted twice – once by the appraisal and again by a formula that allowed the price to increase by only a portion of the appreciation reflected by the appraisal.

It should also be noted that the initial appraisal process used for appraisal-based formulas can also serve the purposes of the leasehold mortgage lender who will finance the home for the next purchaser; *however*, the lender will then proceed to calculate a “bottom line value” (the value of the improvements and leasehold interest in the land) that is different from the value that will be used in calculating the resale price. See Chapter 20, “Financing CLT Homes,” for more information regarding the appraisal of the leasehold interest.

The basic idea behind all appraisal-based formulas is that the homeowner should receive a share of the appreciation of that part of the overall property that the homeowner has purchased. The original assumption was simply that what the homeowner has purchased is the improvements only, which are deeded to her, but not the land in which she has only a leasehold interest. In some respects, however, the reality is more complicated than this assumption suggests. Because of these complications there have come to be three subtypes of appraisal-based formula.

- *Improvements-only appraisal-based formulas*, which give the seller a share of the appreciation of the appraised value of just the improvements.
- *Simple appraisal-based formulas*, which give the seller a share of the appreciation of the appraised value of the whole property, including land as well as improvements (usually a smaller share than given by improvements-only formulas).
- *Compound appraisal-based formulas*, which give the seller a share of the appreciation of that portion of the value of the whole property that the base price actually covers.

We will review the specific advantages and disadvantages of these subtypes, but before doing so let us look at the overall advantages and disadvantages shared by all appraisal-based formulas.

#### ***Advantages of (All) Appraisal-Based Formulas***

- These formulas allow homeowners to capture a modest amount of appreciated value, while preventing expensive improvements from pushing the resale price beyond the level of affordability (since the owner receives only a portion of the value added by improvements).
- These formulas avoid all of the difficulties involved in distinguishing repairs from improvements and assessing the value of improvements, and there is no need to intrude on the owner’s privacy and sense of ownership to approve and evaluate improvements (though improvements may still be regulated for reasons unrelated to the resale formula).
- Because these formulas rely on professional appraisals, utilizing standard techniques for appraising market value, the CLT itself does not have to make difficult and potentially controversial assessments of value.
- Detailed record-keeping and fussy arithmetic are not required, relieving CLT personnel of burdensome tasks, and avoiding the confusion and conflict that can result from inaccurately or incompletely maintained records.

#### ***Disadvantages of (All) Appraisal-Based Formulas***

- Appraisals entail significant time and expense. Homeowners cannot know exactly

what resale price they will be permitted to receive unless or until an appraisal is completed.

- During periods of rapid market appreciation, these formulas may give an unduly high rate of return to owners who sell only a few years after having purchased with little or no down payment.
- These formulas do not distinguish between value added by the owner and value added by market factors beyond the owner's control. In most market situations, an owner who has made substantial improvements will recapture only a portion of what she has invested. There is therefore less incentive for making improvements, and perhaps less incentive for repairs and replacements as well.
- These formulas do not isolate that portion of apparent appreciation that results from monetary inflation. If the local real estate market is appreciating only at the rate of inflation, a long-term owner who receives only a portion of this apparent appreciation will receive less value than she has invested.

**Improvements-only appraisal-based formulas.** Most, if not all, of the CLTs that first adopted appraisal-based formulas adopted this “improvements-only” type, and it is the type that was illustrated in the previous versions of the Model Lease. Typically these formulas allocate something like 25% of the appreciated value of the improvements (but not the land) to the homeowner, though some allocate a higher percentage, and some adjust the percentage upward as a homeowner's tenure increases (e.g., a percentage ranging from 5% after 1 year to 30% after 30 years).

Improvements-only formulas are based on the assumption that the improvements are *the* property that the homeowner purchases – therefore the property in which the homeowner has a right to share in appreciation that is likely to derive, at least in part, from the owner's own efforts. If the market value of the underlying land increases, on the other hand, it is assumed that the appreciation has been generated by the surrounding real estate market, not by the owner of the improvements.

In clearly distinguishing between land value and improvement value, improvements-only formulas are solidly based on the fundamental CLT precept that land and improvements should be treated differently. Land tends necessarily to appreciate because it is a finite resource. The supply of land cannot be expanded to meet increasing demand, whereas the supply of housing units, as products of human industry, can always be increased. To be sure, housing is a “lumpy” commodity, which cannot be produced overnight and, once produced, cannot be shipped to wherever the demand exists, so local shortages do occur, but the supply does eventually catch up.

As compared to other types of appraisal-based formulas, improvements-only formulas have the important advantage of excluding increases in land value from the determination of resale prices. At least they do this in so far as the nature of real estate appraisals makes it possible to do so, but there are some limitations on what is possible in this respect.

The primary method of appraising owner-occupied homes is the “market comparison” method, by which a home is compared to more or less similar homes that have recently sold, for known prices, in the vicinity of the subject home. The sale prices of the “comparables” provide a base, from which value is added or subtracted as the subject property is compared, feature by feature, to these comparable properties.

When the value of a CLT home (improvements only) is appraised through a comparison with recently sold properties that include land as well as improvements, then, if a simple appraisal-based formula is used, the market value of the land must be subtracted from the prices of the comparables. Conceptually, this adjustment is one with which professional appraisers have no problem, since they are accustomed to adjusting market comparisons to account for differences in site value. However, these adjustments can be quite imprecise.

The precision of this method depends on the existence of relevant comparables for both land and improvements. The method is most dependable in situations such as recently developed suburban areas, where most homes *and most lots* can be closely and meaningfully compared. It is least dependable in low-income neighborhoods, which are typically affected by disinvestment or by complex patterns of disinvestment and reinvestment, with older buildings in widely varying conditions. In such neighborhoods, good comparables may be hard to find.

It can become particularly difficult to establish the value of *land* through the comparison method in disinvested neighborhoods. In such circumstances land may actually have a kind of negative market value. The “undesirable” location of a lot can reduce the value of a building on that lot to an amount substantially below the replacement cost of the building, so the land actually subtracts value from the building, rather than adding value to it. But an appraisal by the market comparison method in such a neighborhood will not assign a negative value to the lot. It will recognize the effect of the location on the overall value of the property, but it will do this, in effect, by reporting the value of the building itself as less than its replacement cost, while assigning a nominal positive value to the lot. If the neighborhood later becomes a more desirable place to live – perhaps through the neighborhood improvement efforts of the CLT itself – an appraisal will then show the building itself having *gained* substantial value. Really it is the land (location) that has gained value, but the appraisal may assign much or all of the increase to the building.

Even in less extreme market situations, it remains difficult for appraisers to distinguish precisely between the part of a property’s value that derives from the land and the part that derives from the improvements. This is one of the disadvantages of improvements-only formulas. Another disadvantage stems from the fact that, because most real estate transactions do not require anyone to separate the value of improvements from the value of the land, there is virtually no record of historical trends in the prices of improvements separate from land. There is therefore no precise way that a new CLT can test the way an improvements-only appraisal-based formula would have performed in the local market over past years, as can be done with other common types of formulas.

A final disadvantage of these formulas lies in the fact that the base price that the homebuyer pays is usually not the same as the appraised value of the improvements – which raises a question of fairness, especially in expensive markets where the homeowner may actually pay for a significant portion of the land value as well as the value of the improvements, as will be noted below in connection with the discussion of “compound appraisal-based” formulas.

**Simple appraisal-based formulas.** These formulas directly address the difficulties entailed in trying to separate the value of improvements from the value of land: they simply do not separate them. They measure the appreciation of the combined value of both land and improvements, and then allocate to the homeowner a percentage of this appreciated value that

is normally smaller than would be assigned by an improvements-only formula in the same circumstances.

Because they eliminate one of the variables inherent in improvements-only formulas, these formulas are in fact simpler to apply, and it can be argued that, if the homeowner's share of appreciation is set at an appropriately low level, the simple formula will be as effective as improvements-only formulas in preserving affordability against rising land values. Another advantage is that, because reliable historical data is available regarding trends in home sale prices (land and improvements combined), it is possible for new CLTs to determine with some precision the effect that such a formula would have had on resale prices over past years.

In their simplicity these formulas abandon the significant distinction between the factors that may cause increases in the value of land and improvements. They may *limit* the effect of increasing land values, but they do not screen it out. Therefore, in an effort to preserve affordability against rising land values, they must allocate to the homeowner such a small percentage of overall appreciated value that there will be little economic incentive for preserving and enhancing the value of the improvements. The percentage may also be so low that, in any but the hottest real estate markets, resale prices will not keep up with inflation.

It should also be noted that, like improvements-only formulas, simple formulas do not take into consideration the percentage of a property's appraised value that the homeowner actually paid for through the base price. For this reason, the owner of a deeply subsidized home will receive a significantly higher rate of return than the owner whose base price covered most of the appraised value of the property. For instance, suppose a home that appraised for \$100,000 is sold to one buyer for \$90,000, while a home appraised for the same amount is sold to another buyer, requiring more subsidy, for \$60,000. Suppose that over a certain period of time the appraised value of both homes increases to \$150,000, and both homeowners receive a 20% share of the \$50,000 appreciation. The purchaser of the less deeply subsidized home will receive a 11.11% return, over the time of her ownership, on the investment of \$90,000. The purchaser of the more deeply subsidized home will receive a 16.67% return on the investment of \$60,000. The lack of fairness here can be seen as a problem.

**Compound appraisal-based formulas.** What we have chosen to call “compound appraisal-based formulas” give homeowners a percentage of the appreciated value of that portion of the total property that they have actually paid for through the base price. These formulas are like simple appraisal-based formulas in that they begin with the appreciated value of *both* land and improvements. And they are like improvements-only formulas in that they give the homeowner a specified percentage of only a *part* of that overall appreciation – but a part defined not in terms of the distinction between the value of land and the value of improvements but in terms of the distinction between the value covered by the base price and the value covered by the subsidy.

The first step in implementing these formulas is to determine what percentage of the total value of land and improvements is covered by the base price – by dividing the base price by the appraised value of the total property at the time of purchase. At the time of resale, the amount of any appreciation for the total property is multiplied by this percentage to determine the amount by which the value of what the homeowner paid for has appreciated. The CLT then applies its “appreciation sharing percentage” to the resulting amount. For example, let's look again at the two homes described above, both of which appreciated in value from

\$100,000 to \$150,000. For the home originally purchased with a base price of \$90,000, the base price covers 90% of the value. If the appreciation sharing percentage is then 25%, the seller would receive a share of appreciation equal to 25% of 90% of \$50,000 – or \$11,250 (thus a total resale price of \$101,250). For the home originally purchased with a base price of \$60,000, the base price covers 60% of the value. If the appreciation sharing percentage is then 25%, the seller would receive a share of appreciation equal to 25% of 60% of \$50,000, or \$7500 (thus a total resale price of \$67,500). Both homeowners thus receive a 12.5% return on investment over the time of their ownership.

As this example illustrates, these formulas have the advantage of being fairer than simple appraisal based formulas, which provide a lower rate of return for those able to pay a higher base price (those needing less subsidy) than for those paying a lower base price (those needing more subsidy). It can also be said that these formulas are fairer than improvements-only formulas, which give a higher rate of return to those whose base price was less than the original value of the improvements alone, and a lower rate of return to those whose base price was greater than the value of the improvements alone (whose base price paid for a part of the cost of land).

Like simple appraisal-based formulas, compound appraisal-based formulas have the additional advantage of avoiding the imprecision and inconsistency entailed in distinguishing the value of improvements from the value of land. Also like simple appraisal-based formulas, these formulas have the disadvantage of allowing resale prices to include some portion of appreciated land value, which in hot real estate markets may undermine affordability.

As compared with both improvements-only and simple appraisal-based formulas, compound appraisal-based formulas have the disadvantage of being harder to explain, and, on a superficial level, more complicated to justify. Though these formulas are actually fairer than other appraisal-based formulas, it may still strike some people as unfair to give the homeowner only a “piece of a piece” of appreciated value.

**Other variations of appraisal-based formulas.** Some of the disadvantages of the several types of appraisal-based formulas discussed above can be addressed through other kinds of variations. Inevitably, these variations give up some of the simplicity that is the central advantage of appraisal-based formulas, but they may still be worth considering. One such variation is discussed below. Others are possible.

*Appraisal-based formulas with capital improvement factors.* These formulas combine certain features of itemized and appraisal-based formulas. Like most itemized formulas, they credit the homeowner with equity for the value of at least certain specified major improvements made at the owner’s expense. Then they allocate to the homeowner a certain percentage of any additional appreciation, beyond the value of the owner’s improvements, as determined by appraisals. For example, suppose a CLT homeowner has paid a base price of \$80,000 for a home (improvements only) that appraised for \$80,000 (land cost being subsidized), and has then made improvements (e.g., added a bedroom) that have been duly valued at \$10,000. When she decides to sell the home, it is appraised at \$120,000. If the CLT’s formula allocates 25% of additional appreciation to the homeowner, the resale price would be calculated as follows: \$80,000 base price, plus \$10,000 in improvements, plus 25% of the \$30,000 additional appreciation (\$7500) equals a resale price of \$97,500. If the formula had not included an improvement factor and she received a straight 25% of the total \$40,000 appreciation, the resale price would have been \$90,000. This example involves an

improvements only appraisal-based formula, but other formulas can be varied in this way as well.

This type of variation avoids one of the major disadvantages of other appraisal-based formulas (failure to compensate owners directly for their direct investments in improvements), but in doing so it assumes one of the disadvantages of itemized formulas (the burden of defining and assessing the value of improvements). However, most of the CLTs that have adopted such formulas have kept this burden within manageable bounds by limiting the improvements for which equity can be earned to a specific list of useful, separately appraisable major improvements such as the addition of a bedroom or a garage.

**Fixed-rate formulas.** The simplest of all types of resale formulas, fixed-rate formulas adjust the resale price upward by applying what is in effect a fixed rate of interest on the base price (not the settlement price) from year to year. At any given time, a simple mathematical calculation will allow either the CLT or the homeowner, independently, to determine the then current purchase option price.

This type of formula has become increasingly common in recent years. The percentage rates applied in these formulas typically range from 2% to 3%. In most cases the rates are compounded annually – so that the rate is applied at the end of each “ownership year” to an amount equal to the original base price plus accumulated “interest” as of the beginning of that year.

Both the advantages and disadvantages of these formulas flow from the fixed and simple nature of the mechanism. They require neither the burdensome record-keeping and potential disagreements entailed by itemized formulas nor the expensive and time-consuming appraisals required by appraisal-based formulas. They make it easy not only to determine the present purchase option price but also to project what the price will be at any given time in the future. By the same token, there are potential disadvantages in the fact that these formulas do not establishing any particular relationship with either current market conditions or the homeowner’s efforts to preserve or enhance the value of the home.

#### ***Advantages of Fixed-Rate Formulas***

- These formulas are extremely easy to apply, involving no record keeping by the CLT and no difficult judgments.
- Since they do not depend on appraisals or other external events or conditions, they allow homeowners to know exactly what price they can receive for their homes at any given time – now or in the future.
- These formulas do not allow resale prices to be pushed upward beyond the intended level of affordability by spikes in the local housing market (as appraisal-based formulas may) or by sharp rises in consumer prices or wages (as indexed formulas may).
- These formulas recognize the homeowner’s interest in receiving some return on her investment in the home, while limiting that return to a level likely to keep the home affordable for the next buyer.
- Unlike indexed formulas, fixed-rate formulas avoid the possible complications that can result from changes in the ways indexes are generated or published.

### ***Disadvantages of Fixed-Rate Formulas***

- Like the indexed formulas described below, fixed-rate formulas do not distinguish between “earned equity” and “unearned equity,” since the purchase option prices they yield have no relationship to the degree to which the homeowner maintains or improves the home. They do not provide an economic incentive for sound maintenance.
- Like indexed formulas, these formulas guarantee a high rate of return for “highly leveraged” short-term owners, while providing only a limited return for long-term owners who have paid off their mortgages.
- In weak housing markets, these formulas can allow resale prices to increase faster than market prices, thereby diminishing the effect of the subsidy and making marketing more difficult.
- When the rate of inflation exceeds the fixed rate applied by these formulas, the real value of the resale price for the seller will be less than the original purchase price.

**Indexed formulas.** By “indexed formulas” we mean formulas that adjust the resale price (above or below the purchase price) by applying a single factor drawn from an index such as area median income or the Consumer Price Index. Indexed formulas were once rare among CLTs but have become relatively common. Such formulas – especially those that use area median income as the index – are also common among non-CLT resale-restricted homeownership programs.

Median-income-based formulas are sometimes a response to government program regulations requiring that homes subsidized through the program remain affordable for a certain number of years for households of a given income level. Since income levels are conventionally defined in terms of percentages of HUD’s adjusted figures for area median income (AMI), the simplest way to achieve probable compliance with these regulations is to allow the resale price to increase beyond the purchase price only in proportion to increases in AMI. Thus, for instance, if an \$80,000 purchase price is affordable for a family at 80% of AMI, and if AMI increases by 25% during the period of a family’s ownership, the home may be resold for 25% more than the purchase price ( $\$80,000 + \$20,000 = \$100,000$ ) and still be presumed affordable (if mortgage interest rates do not rise) for a family at the now-increased 80-percent-of-AMI level. It should be emphasized that (except as noted in the following paragraph) the adjustment here is applied to the purchase price, not just to the owner’s equity as in the case of the inflation adjustments included in some itemized formulas.

With both fixed-rate and indexed formulas, the relationship between the settlement price and the subsidy will have especially important consequences. As noted above in the section on “Defining the Base Price,” subsidies that are structured as deferred loans or grants *to the homebuyer* are normally *included* in the settlement price – i.e., a market-rate price is made affordable for the buyer by assistance provided directly to the buyer, not by subsidizing the CLT’s costs and thus reducing the price that must be charged to the buyer. In such situations, there is an important distinction to be noted between the application of the index to the settlement price (including the subsidy), and its application to the base price (the amount the buyer actually pays). Application of the index to the settlement price will result in a higher resale price than if the index is applied only to the base price.

In deciding what index to use the following questions are relevant.

- Does the index measure changes in the *cost* of goods (as in the case of CPI) or changes in the *income* of households (as in the case of AMI)?
- Is the index relevant for the *population* being served?
- Is the index relevant for the *area* being served?
- Is the index *consistent* from year to year?
- Is the index published with enough *frequency* and *reliability* to be available and current when needed?
- Is the index published by an *objective, reputable* public or private agency?
- Can the average person easily *understand* the index and, if necessary, easily *confirm* for herself that the CLT is using the correct index information?

#### ***Advantages of Indexed Formulas***

- These formulas allow a reasonable return to the homeowner while limiting resale prices to a level that is likely, though not certain, to be affordable for other households at the same income level as the initial family.
- Though not as simple as fixed-rate formulas, these formulas are relatively simple and comprehensible and do not require subjective judgments by either CLT personnel or professional appraisers. Occasions for misunderstandings or disputes are minimized.
- Compared to appraisal-based formulas, these formulas are likely to provide a return to the homeowner that is more predictable and less drastically affected by the ups and downs of local real estate markets (though not as predictable as fixed-rate formulas).
- Information regarding common indexes is readily and continuously available, so it is relatively easy for a CLT to provide periodic reports of what the formula price of a home would be if the owner were to sell at that time.
- These formulas – particularly AMI-based formulas – should easily be approved under the guidelines of public subsidy programs with which a CLT may be working, without the need for complicated negotiations.
- Compared with fixed-rate formulas, these formulas – particularly CPI-based formulas – are more likely to allow the real value of resale prices to keep up with inflation.

#### ***Disadvantages of Indexed Formulas***

- Because these formulas do not distinguish between value produced by the owner and value produced by other factors, they may not provide adequate incentive for maintenance and repairs – and may fail to provide a reasonable return on actual investment for owners who actually improve their homes.
- A formula that allows resale prices to rise at the same rate as area median income (or at the rate of the CPI) may not preserve real affordability for lower-income households. Low-income people often do not benefit from economic trends reflected by area-wide median income (particularly in the case of “Standard Metropolitan Statistical Areas” that include affluent suburbs as well as low-income neighborhoods). Resale prices pegged to median income may tend to widen the gap between *haves and have-nots*. Indexes, such as CPI, that reflect *costs* can have a similar effect, since increases in the costs borne by low-income people can easily outstrip increases in their incomes.

- The leverage provided by these formulas is likely to yield an unduly high rate of return for short-term owners.
- In weak housing markets, these formulas can allow resale prices to increase faster than market prices, thereby diminishing the effect of the subsidy and making marketing more difficult.
- For the long term there is no guarantee that indexes will continue to be generated and published as they are now. Discontinuation or significant changes in an index would create major problems for CLTs relying on that index.

### Testing Possible Formulas for Your Area

Testing the possible consequences of different types of formulas is obviously an important part of the formula design process. Those charged with designing a CLT's resale formula should test each specific formula that is considered by projecting its effect on resale prices for different homeowner situations in different hypothetical economic situations, including the economic situation that has prevailed in the immediate area over the past ten years or longer. For instance, they should try to answer the hypothetical question: if a home was purchased ten years ago for a given price that was affordable for a household of a given size at a given percentage of median income, and if home prices in the area have increased by a given percentage, and if median income has increased by a given percentage, and if interest rates have (or have not) increased or decreased by a given number of points, how would the affordability of the home compare with what it was ten years ago. The availability and reliability of the data needed to address such a question will vary from area to area, as well as from one type of data to another, but it should be possible to find relevant data, of most types, for most areas.

**Sources of information.** In general, HUD-adjusted median income data is available for all "metropolitan statistical areas" (MSAs) and all counties that are not part of an MSA. Be aware, however, that the year-by-year HUD adjustments involve interpolations or estimations of trends for years in between national census years. The decade-long cumulative effect of these interpolations is corrected when new census information becomes available, and in some cases the correction may create the appearance of a sudden one-year increase or decrease in median income. For this reason, apparent trends from one census year to the next will be more reliable than apparent trends for ten-year periods that bridge only a single census year.)

Information regarding changes in local and regional median home prices is generally available from local and regional associations of realtors. This information normally does not distinguish between land costs and the costs of improvement. If you want to test an improvements-only appraisal-based formula, you will need to estimate the percentage of the overall price that derives from the value of improvements rather than land. Local appraisers should be able to help you develop a reasonable estimate of the average percentage..

It is of course true that projections of *future* home prices based on information regarding *past* trends can sometimes be dramatically unreliable. Projections made in 2007, at the height of the "housing bubble," based on housing market trends over the previous ten years, were anything *but* reliable indicators of what turned out to be the collapse of home prices in many markets between 2007 and 2009. Nonetheless, it is important to have as much information as possible about historical trends – and to have year-to-year information as well as information

about long-term trends. In other words, it is important to consider not only the affordability of homes purchased ten years ago and sold today but also the affordability of homes purchased and sold at various times within that ten year period where resale prices could be affected by shorter-term changes in the market.

Information regarding changes in the consumer price index is available from the US Bureau of Labor Statistics ([www.bls.gov](http://www.bls.gov)) for those wanting to test a CPI-based indexed formula (or wanting to check, for other types of formulas, the relative buying power of dollars received by a homeowner at resale as compared with dollars spent on the original purchase).

**Burlington Associates interactive tool.** All designers of resale formulas will want to make use of the “interactive resale formula comparison tool” that can be found in the Burlington Associates CLT Resource Center ([www.burlingtonassociates.com/](http://www.burlingtonassociates.com/)). The tool allows you to test various appraisal-based, indexed, “fixed-rate,” and mortgage-based formulas over different “holding periods,” under different economic conditions. For a given formula you can specify the cost of producing the home, the amount of subsidy to be applied, the length of time the home is owned by the initial buyer, and projected rates of median home price inflation (or deflation), median income inflation, and different interest rates. The tool will then calculate the initial purchase price and affordability level (percent of AMI for which the price is affordable), the resale price, the seller’s equity upon resale, and the affordability level of the resale price.

The tool includes four identical calculators in side-by-side columns, so you can easily compare the results of four different formulas acting on the same basic assumptions about cost and economic trends. Another extremely useful feature is a link to sites providing historical data on median home price trends and median income trends for every MSA in the country.

The great virtue of this tool is that it makes it so easy to test the effects of multiple formulas under many different sets of circumstances – and you should make full use of this virtue. As the recent “bursting of the housing bubble” should remind all of us, we should consider the consequences of hypothetical circumstances that deviate significantly from past trends as well as circumstances that sustain past trends. The resale formula comparison tool makes it easy to look at all sorts of hypothetical situations. It also makes it easy to look at the effects of different approaches to subsidy allocation and pricing on the affordability (and marketability) of resale prices for different formulas in different circumstances. As emphasized in Chapter 19, “Project Planning and Pricing,” initial pricing should provide enough “cushion” so that neither affordability nor marketability is likely to be wiped out by changes in market conditions.

## Implementation

The specific concerns and responsibilities involved in implementing a resale formula will depend on the specific formula a CLT adopts and on other aspects of the relationship between the CLT and its homeowner-lessees. However, there are some basic concerns that are important for all CLTs.

**Building consensus in support of the formula.** The model Classic CLT Bylaws presented in Chapter 5-A require that the CLT’s resale formula be approved by a two-thirds vote of the organization’s membership as well as by its Board of Directors. It is important that this approval be based, as much as possible, on a real understanding of the issues and a real

acceptance of the formula itself – not on blind faith that the board or committee members “must know what they’re doing.” A new CLT should involve as many people as possible, representing as many constituencies as possible, in the process of deciding on the formula.

A smaller committee will need to coordinate this process and do the careful background work needed to test the possible consequences of different types of formulas, but the committee should consult regularly with the membership. The pros and cons of alternative approaches should be explained, and feedback from the membership should be invited.

The fact that this will necessarily be a slow process should be seen as an advantage, rather than a burden. Price restrictions go against the grain of traditional American attitudes toward real estate. Your resale formula will almost certainly be questioned. As John Davis has written, “There will be skeptics, critics, and opponents aplenty *outside* of your organization, without fostering them on the inside as well. The process of adopting a limited equity formula should be gradual enough and inclusive enough to earn the full understanding and wholehearted support of most – if not all – of your members.”<sup>4</sup>

**Ensuring informed consent from homeowners.** Informed consent is of course necessary if the terms of the ground lease, including the CLT’s preemptive option, are to be legally enforceable. Informed consent is also essential if the CLT and its approach to resale-restricted ownership are to be accepted and supported in the community. Any suspicion that the CLT’s homeowners are in some sense “duped” – that they do not really understand what they are doing when they purchase a home and enter into a ground lease agreement that limits the resale price of their home – can seriously undermine support for the organization.

The Model CLT Ground Lease provides a means of documenting informed consent through the “Letter of Agreement,” which states the homeowner’s own understanding and acceptance of the agreement, and the “Letter of Attorney’s Acknowledgement,” which confirms that an attorney has reviewed the lease and related documents with the homeowner. But the process of informing the homeowner about the nature of limited equity ownership must obviously begin well before the signing of documents – and before counsel discusses the actual documents with the homeowner. Explaining the nature of this “different kind of homeownership” is an important ongoing concern for all CLTs – from initial contacts with potential home-buyers, through orientation sessions for those interested in CLT homeownership, on through the “resident selection” process, and beyond.

It should also be emphasized that such efforts to ensure informed consent are important each time a CLT home is transferred to a new owner – not just the first time a home is sold by the CLT. CLTs should be careful not to neglect these efforts in situations where a home is resold directly to a household identified by the prior owner. In such cases the CLT should be sure not only that the buyer is income-qualified but that she fully understands and accepts the resale formula and other provisions of the ground lease. CLTs should also be sure that those who receive CLT homes through inheritance fully understand and accept these provisions. Letters of Agreement and Attorney’s Acknowledgement are especially important in situations where a new homeowner has not been through a formal CLT orientation program with other potential CLT homeowners.

Every CLT should make sure that all personnel who may have occasion to explain the resale formula to prospective homebuyers are prepared to give fully accurate explanations. Because the task can seem dauntingly complicated, it can be very tempting to offer an over-simplified explanation, but over-simplification can be dangerous. For instance, potential

buyers are being seriously misinformed if they are told, “The formula gives you back what you have invested in the home but not more than that,” if in fact the CLT has an appraisal-based formula (or any type other than certain itemized formulas). If such a buyer eventually wants to sell and finds that the formula will give her back less than she has invested over time in improvements and repairs, she may come to the CLT and say, “But I was *told*...” At that point the CLT faces a serious problem – one that can easily be amplified into a public relations problem, if not a legal problem. When a CLT representative *cannot* respond to questions with a fully accurate explanation of the resale formula – and certain formulas indeed make this rather difficult – it is best to say, “It’s a little complicated; we’ll get someone to sit down and go over the details with you.”

It is also important to provide carefully prepared written materials to accompany oral explanations of the formula. These materials should be clear and concise – but again not over-simplified – and should include examples of typical resales, showing how an actual resale price is arrived at. Every serious prospect for CLT homeownership should be given such materials.

**Record-keeping.** Though the nature of the records will vary, depending on the specific formula in effect, some form of record-keeping is essential to the implementation of all resale formulas. As has been noted in this chapter, itemized formulas can impose particularly heavy record-keeping burdens on a CLT, and it is important to evaluate the organization’s capacity to bear the burden, consistently, over time, before adopting such a formula. Appraisal-based formulas require much less burdensome record-keeping, but it is still crucial to preserve the relevant documents – including the signed appraiser’s report completed at the time of purchase (a copy of which should be attached to the ground lease). Generally, CLTs should remind themselves that they not only need to collect the information required to calculate the purchase option price at the time of resale, but must be able to document and preserve this information.

**Reporting and retraining.** Most CLT homeowners pay close attention to the resale formula in their ground lease at only two times: when they first purchase their home and when they later resell it. Years, even decades, may pass between these times. It is a mistake for a CLT to allow this period to pass without reminding its homeowners of the conditions and limits that are placed on the resale of their homes. The formulas used by some CLTs (fixed-rate and indexed formulas, in particular) allow the CLT to report periodically to its homeowners what the formula-based prices of their homes would be if they were to sell them at that time. This kind of reporting is an important way of reinforcing the homeowners’ understanding of the limited-equity arrangement and, at the same time, a way of reassuring them that the CLT is fully accountable and attentive to their rights. It should greatly reduce the likelihood of misunderstandings or disputes at the time of resale. Even formulas that do not lend themselves to periodic reporting of what the current resale price would be (notably appraisal-based formulas) should be periodically reviewed with homeowners who are subject to them. It may be as important to offer long-time CLT homeowners an occasional “refresher course” in the details of their resale formula as it is to offer an introductory course to a first-time homebuyer who is considering the purchase of a CLT home.

**Amending resale formulas.** Classic CLT bylaws, as presented in Chapter 5-A, make it difficult to change a resale formula after it has been adopted. The balance of interests within

the classic CLT board, the balance of powers between the CLT's membership and its board, and processes for amending either the CLT's bylaws or the resale formula itself, which require super-majorities of both the board and the membership – all of these make it difficult to amend a resale formula without a careful, deliberate process and broad-based eventual approval. The CLT is a model that was designed, in part, to avoid the mistakes made by earlier models of affordable housing where controls over resale prices were easily relaxed and, in many cases, eventually removed. Demanding as the amendment process may be, however, resale formulas can be amended, and a time may come when a CLT will have reason to consider altering its formula. Should that time arrive, a CLT should devote as much time and care to amending its formula as it devoted to creating and adopting that formula in the first place.

It should be noted that any changes in the resale formula cannot be unilaterally imposed on leases already in effect. The homeowners themselves must agree to have their leases amended to include the new resale formula. If any homeowners do not accept the new formula, the CLT will have different formulas in effect for different leaseholds. This is a state of affairs that CLTs should clearly try to avoid; nonetheless, it is possible that it will come to pass during a transition from one formula to another.

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<sup>1</sup> Our discussion of the promotion of homeowner mobility has been limited to lateral mobility. It should be noted that some may express a concern with promoting vertical mobility as well, suggesting that CLT homeowners should be able to sell their homes for enough money to allow them to move into the traditional market or to “move up” to a more expensive home. Few people would argue against the idea that CLT homeownership can and should promote this kind of vertical progress over the long term, as an owner's equity increases through debt repayment and perhaps through improvements to the home, and as lower monthly housing costs promote savings. The question is how much equity the CLT homeowner should be allowed to claim from market appreciation that she herself did not cause. Many supporters of the CLT model would answer “none.” Nearly all would answer “as little as possible,” because every dollar of socially created appreciation claimed by a homeowner today makes housing less affordable for another low-income homebuyer tomorrow.

<sup>2</sup> As noted, the U.S. Department of Agriculture's “502 program,” administered by Rural Housing Services, has provisions for recapturing interest subsidies out of any appreciated value at the time of resale. The definition of “appreciated value” employed by the 502 Program (which determines appreciated value based on an appraisal at the time of resale) had raised issues for CLTs, since CLT resale formulas can result in resale prices that are substantially less than the appraised value of the home. However, the Housing and Community Development Act of 1992 specifically provides that, for purposes of recapturing interest subsidy for CLT homes under the 502 Program, appreciated value is to be measured based not on appraised value but on the actual resale price under the CLT's formula.

<sup>3</sup> The “*appraisal-based*” price restrictions that are employed by certain programs to keep the resale prices of farms affordable for farmers are different from the “appraisal-based formulas” used by CLTs for residential property to determine the amount of appreciation to be shared between homeowner and CLT. These agricultural price restrictions, which may be embedded in ground leases or conservation easements that require agricultural use of the property, call

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for appraisals of the as-restricted agricultural value of the property, which then *becomes* the purchase option price for the holder of the easement. For detailed information on agricultural price restrictions, see *Preserving Farms for Farmers: A Manual for Those Working to Keep Farms Affordable*, Equity Trust, Inc., 2009.

<sup>4</sup> John Emmeus Davis, unpublished monograph prepared for ICE in 1985.

## Chapter 13

# Establishing and Collecting Fees

This chapter is concerned with the fees charged by a CLT land-owner to a lessee-homeowner in return for the right to occupy and use the land (or land and improvements if title is not separated) and for other services provided by the CLT. The chapter's first concern is the basic "lease fee" (sometimes called "ground rent" or "land-use fee" or "ground lease fee"), which is normally charged on a monthly basis. Other types of fees, including the "transfer fees" that are increasingly common among CLTs, are discussed at the end of the chapter.

### Basic Lease Fee Considerations

The process of deciding on the amount of lease fee to be charged involves a number of considerations. We will first discuss the basic factors that all CLTs should consider in designing a lease fee; then note common types of variations and adjustments that should be provided for in establishing a fee structure. We will also review some more specialized considerations, including ways in which the IRS may be concerned with the amount of the lease fee charged by a tax-exempt organization, and ways in which mortgage lenders are also concerned with the amount of the fee.

Older CLT leases (following the version of the Model CLT Lease published in the 1991 edition of ICE's CLT Legal Manual) describe the lease fee as the sum of three components, identified as the "pass-through charge," the "administrative charge," and the "land use charge." The version of the Model published in the 2002 edition of ICE's CLT Legal Manual takes a different approach, replacing the three-part fee structure with a single fee, conceptualized in somewhat different terms. The current (2010) Model changes the approach yet again by adding a component to the fee that is dedicated to the funding of a reserve for long-term repairs to the home, so that the overall lease fee defined in the Model now consists of a "land use fee" plus a "replacement reserve fee."

Regardless of how the fee is structured and described in the lease, it is possible to identify basic considerations that should be addressed in one way or another as the lease defines the fee and determines the amount to be charged. These considerations include the following:

- passing on the direct costs of land ownership,
- funding the CLT's administrative costs,
- setting a fair charge for value received by the homeowner,
- keeping the charge affordable for the homeowner,
- providing for periodic adjustments of the amount charged,
- funding a long-term repair reserve.

Some of these considerations relate primarily to the needs and interests of the CLT; others focus on the needs and interests of the homeowner. As with other features of the CLT ground lease, some "balancing" of these two sets of interests will be necessary.

**Passing on direct costs of land ownership.** The CLT's direct expenses as owner of the land usually include taxes on the land, and may also include special assessments and certain insurance expenses. CLTs normally pass on these expenses to the lessee-homeowners, either by increasing the lease fee by an amount equal to the amount of the expense or by requiring the homeowners to pay the expenses themselves.

*Property Taxes.* CLT homeowners are normally taxed for the value of buildings and other improvements that they own on the land; the CLT itself, as owner of the fee interest in the land, bears the responsibility for taxes on the land's value, though CLT leases normally pass on the responsibility for paying this tax, as well as taxes on the improvements, to the homeowner – by one of the two methods noted above. (Regarding the ways these values are assessed to determine the amount of taxes to be paid, see Chapter 17, “Property Tax Assessment.”)

The advantage of the tax payment procedure embodied in the “old” Model Lease (treating taxes on the land as an expense of the CLT for which the CLT will be reimbursed through the “pass-through” component of the lease fee) is that the CLT, by paying the land taxes itself, is assured of the power to prevent the possible loss of control of its underlying interest in the land as a result of nonpayment of property taxes. On the other hand, the advantage of assigning responsibility for these taxes directly to the homeowner is that the CLT is relieved of the significant administrative burden of making annual adjustments in lease fee amounts, leasehold by leasehold, notifying homeowners of these changes, and following up to insure payment.

The practical consequences of the CLT's decision on how to handle land taxes are also shaped by two other factors. First, local practices vary in the extent to which taxes on land and improvements are assessed and reported separately. Though it should usually be possible to break out separate assessments – one for the CLT, one for the homeowner – getting the local tax authority to do so may require a special effort by the CLT (see Chapter 10, “Legal Issues Re. CLT Ownership,” and Chapter 17, “Property Tax Assessment”). Second, the whole question of which party has direct responsibility for paying land taxes can be rendered moot if a mortgagee requires – as mortgagees often do – that *both* the taxes on the improvements *and* the taxes on the land be paid with monthly mortgage payments and escrowed until due to the taxing authority. (As noted below, it is generally a convenience to a CLT if a mortgagee collects, escrows and pays all taxes – and perhaps other components of the lease fee as well.)

The danger that a homeowner who is directly responsible for the taxes on the land may fail to pay them and thereby threaten the CLT's continued ownership of the land can be mitigated through lease provisions such as those contained in section 6.4 of the Revised Model Lease, allowing the CLT to add any delinquent taxes to the lease fee in the event that the homeowner has failed to pay the taxes directly when due.

*Special Assessments.* Special assessments, separate from real estate taxes, are often levied by local governments to cover the cost of public improvements such as water lines or sidewalks that provide direct benefits to particular properties. Clear provisions should therefore be made to pass these assessments on to homeowners, either directly or as an addition to the lease fee. The current Model Lease assigns responsibility for assessments directly to the homeowner. It should be noted, however, that special assessments sometimes place severe economic burdens on lower income people, who may not have asked for, or needed, the improvements they are being required to pay for. A CLT may be better able to advocate against or mitigate such burdensome measures if the assessments come directly to the CLT.

*Liability Insurance.* The Model Lease assigns the rights and responsibilities of land use to the homeowner and requires the homeowner to carry liability insurance on the leased premises (see Chapter 10, “Legal Issues Re. CLT Ownership,” on the liability of CLT and homeowner, and Article 9 of the Model Lease). Nonetheless, some CLTs have chosen to obtain their own liability insurance covering their interest in the land as lessor. The old Model Lease allowed the cost of this coverage to be passed on to homeowners as an addition to the pass-through

component of the lease fee. As a practical matter, CLTs with smaller holdings have had difficulty finding a reasonably priced insurance product covering just the marginal liability involved for a ground lessor in such situations. They have had to choose between buying disproportionately expensive landlord insurance or not carrying their own insurance on the land. Some have chosen the latter course. CLTs with large holdings have had better luck in negotiating appropriate insurance for this purpose. Some CLTs – both large and small – that do carry insurance on their leased land have chosen to pay for it as a part of their basic operating costs and not pass it on to homeowners (who are already paying for their own insurance), even when the CLTs' leases would allow them to pass it on as a component of the lease fee.

**Funding the CLT's administrative costs.** Most CLT leases based on the 1991 Model Lease, have defined the lease fee as including both an "administrative charge," conceived as covering at least a portion of the administrative expense entailed by the CLT's role as lessor, and a "land use charge," conceived as fair compensation to the CLT for the use of the land by the homeowner and theoretically earmarked for use for other-than-administrative purposes. The "administrative charge" has usually been established as a (usually very modest) fixed amount, not varying from leasehold to leasehold, and increasing over time only gradually if at all. The "land use charge," on the other hand, has been defined in terms that allow it, potentially, to vary from one leasehold to another to reflect differences in their relative value, and to vary over time to reflect both changes in the value of the property (or the value of currency) and changes in what is affordable for the homeowner.

Notwithstanding these theoretical differences, however, CLTs have generally not allocated the two parts of the fee to different uses; they have simply treated the combined fee as an addition to the overall income available to cover operating expenses. Furthermore, there is generally no direct relationship between the amount of the lease fee that a CLT has described as an "administrative charge" and the amount the CLT must actually spend in carrying out its stewardship responsibilities as ground lessor. Such responsibilities include tracking lease fee payments, monitoring compliance with occupancy and use restrictions, monitoring the condition of homes, maintaining communications with homeowners, working with residents who are having trouble meeting their financial obligations, and overseeing transfers of ownership. Some of these entail routine on-going activities involving predictable costs, but others – especially the task of dealing with transfers of ownership – are activities that must be performed at unpredictable intervals for each leasehold and may involve substantial costs. It is therefore difficult to quantify the cost of carrying out the full package of administrative and stewardship responsibilities, leasehold by leasehold, and year by year. And if it *were* possible to quantify these costs precisely, some CLTs would be likely to find that the total cost is more than the total revenue that can be generated by lease fees if the fees are to be kept affordable for the homeowners.

In any case, it is reasonable to insist that the full amount of the lease fee that is not explicitly restricted to specific purposes (including any pass-through of taxes and assessments and any replacement reserve fee) – should be available to help pay for the package of rights and services received by the homeowner. See Chapter 23, "Post-Purchase stewardship Tasks," and Chapter 27, "Planning for Long-Term Sustainability," for discussions of the CLT's ongoing stewardship Tasks and the question of how to pay for them.

**Setting a fair charge for value received by homeowner.** In describing the way the land use fee is calculated, Section 5.3 of the current Model Lease states, "First, the approximate monthly

fair rental value of the Leased Land has been established, as of the beginning of the lease term, recognizing that the fair rental value is reduced by certain restrictions imposed by the Lease on the use of the Land.” (The 2002 version of the Model uses more or less the same language regarding the calculation of the whole lease fee, which does not include a replacement reserve fee.)

How is this “fair rental value” to be calculated? Setting aside for the moment the question of how the use and resale restrictions will affect market value, let us look at how the fair rental value may be calculated in the absence of such restrictions. Usually, when a CLT home is to be sold, a professional appraisal will be commissioned by the mortgage lender involved in financing the sale. This appraisal will normally show the (approximate) value of land as separate from the value of the improvements. Once a value has been assigned to the land, this value may be translated into fair monthly rental value. Since residential land is usually not rented without improvements, it is unlikely that fair rental value of land alone can be determined with direct reference to comparable rental situations. However, appraisers can determine monthly fair rental value by applying a capitalization rate to the appraised value of the land. Or the monthly rental value can be approximated as the monthly amount that would be needed to amortize the value of the lot over an extended term. (Typically, the value is amortized over 30 to 40 years rather than over the full 99 years of a CLT lease term, since the latter approach would yield an unrealistically low monthly amount.)

Having determined the approximate fair rental value of the land in the absence of use and resale restrictions, you can address the fact that the CLT lease limits the rights of the homeowner in some ways that a more conventional ground lease would not. In particular, CLT homeowners cannot sell or sublease the improvements and leasehold interest for a market rate price. These restrictions clearly reduce the fair rental value of the leased premises, but there is no established method of calculating the exact extent of this effect, and, as noted below, CLTs tend to adjust the amount of their lease fee more in terms of what is affordable for the homeowner than in terms of the effect of use and resale restrictions. In any case, the lease fee charged by CLTs in most markets is much less than what would be charged as a market rate ground lease fee in the absence of resale restrictions. Significant exceptions can be found, however, in disinvested neighborhoods where the market value of land is nominal. CLTs working in such neighborhoods should be aware that even a very low monthly lease fee may actually exceed the amount that could be charged for conventional ground rent. This does not mean that CLT homeowners in these neighborhoods are getting a bad deal. They are usually the beneficiaries of subsidies that substantially reduce the price of the home (and therefore the cost of monthly mortgage payments), and they typically benefit from significant ongoing support services from the CLT as well. Nonetheless, it behooves these CLTs to be clear with themselves and their homeowners that the monthly “lease fee” is not really a below-market land-use charge; it is a below-market charge for a substantial package of benefits of which land use is only one component.

**Keeping the charge affordable for the homeowner.** As should now be clear, there are two different but overlapping rationales for reducing the CLT lease fee to a level that may be substantially lower than what might be charged as conventional market rate ground rent. We have noted that the market value of the leased land is reduced by the restrictions on use and resale that are contained in the lease, and that it is therefore reasonable to charge the homeowner a reduced lease fee in return for accepting these restrictions. For some homeowners, this basic

trade-off – lower lease fee in return for acceptance of restrictions – might result in a monthly charge that, when added to other monthly housing costs, is affordable. But for homeowners with lower household incomes, the same monthly lease fee, based on the same trade-off, might not be affordable. There may therefore be a reason to reduce the lease fee beyond what might be warranted by the trade-off.

Although, as we have said, there is no established method of calculating the extent to which resale and use restrictions reduce the fair rental value of the leased premises, there is an established method of calculating the total monthly amount of housing cost that is assumed to be affordable (as a percentage of gross household income) for a household. For these reasons – and because affordability is a central concern for all CLT programs – CLTs have emphasized affordability as the final consideration in calculating the amount of the lease fee, and have concerned themselves less with the theoretical question of how much the use and resale restrictions reduce the fair rental value of the leased premises.

In the past, some have argued that any reductions in the lease fee that are specifically intended to achieve affordability should be tailored, from year to year, to the current needs of individual homeowners. However, most CLTs have *not* tried to tailor lease fees in this way. The necessary monitoring of household incomes, together with periodic household-by-household adjustments of lease fees, would be burdensome for both CLT and homeowner (and mortgagees as well). Most CLTs have therefore established lease fees as a single set amount that should be affordable for all households in the targeted income range.

Finally, we should emphasize that the CLT's real concern is not the affordability of the lease fee alone, but the fee's effect on the affordability of the household's total housing cost. A reduction in the lease fee can make the household's monthly cost more affordable, but so can an increase in the basic housing subsidy that is intended to yield affordable mortgage payments. For the sake of the long-term sustainability of the CLT's stewardship functions, it is important that these basic affordability subsidies be large enough so that monthly payments can include a lease fee sufficient to support those functions. See Chapter 23, "Post-Purchase Stewardship Tasks," and Chapter 27, "Planning for Long-Term sustainability," for discussion of this important matter.

**Variations and adjustments in the land use fee.** As we have said, CLTs that include taxes or other direct expenses as a component of the lease fee must adjust the amount of the fee as the expenses vary for each leasehold from year to year. Except for this type of adjustment, however, most CLTs have tended to charge a standardized fee. Nonetheless it is important that the fee be structured in such a way that certain kinds of variations or adjustments in the amount are possible when a situation calls for them. In particular, the following kinds of variations and adjustments should be noted.

*Variations Reflecting the Different Values of Different Leaseholds.* Even though a CLT may establish a "standardized" lease fee, it may still have reason to adjust the fee upward or downward for different types of leaseholds, based on:

- differences in the size or location of the leased land, or
- differences in the services to be provided by the CLT, or
- differences in what is affordable for the targeted income levels.

*Periodic Adjustments Reflecting Inflation.* Section 5.5 of the Model Lease provides for the adjustment of the land use fee (or total lease fee in the 2002 version) at intervals of a specified

number of years. Many CLT ground leases provide for adjustments at ten-year intervals. It is possible to provide for more frequent adjustments if the CLT is prepared to assume the added administrative burden. In any case it is important to recognize that, over the years, inflation can substantially reduce the real value (purchasing power) of a given dollar amount of fee income for the CLT, and that the CLT lease should allow the fee to be updated accordingly. Section 5.5 of the Model Lease specifically limits increases to the rate of inflation as measured by the consumer price index, but some CLTs may want the right to increase the amount of the fee, provided it remains affordable, by *more than* the inflation rate in order to cover stewardship costs more fully.

*Adjustments Triggered by Removal of Restrictions.* As we have said, the land use fee (or total lease fee in the 2002 model) is established as fair compensation for the use of the land, given the restrictions on use and transfer imposed by the lease. If these restrictions are removed through foreclosure or other means, the CLT has an interest in collecting the potentially higher fee that would be fair for land not so restricted. Therefore Section 5.6 of the Model Lease provides for such an increase in the event that restrictions are removed. The method for calculating the unrestricted market value of the land is described above, under “Setting a Fair Charge for Value Received by Homeowner,” as the first step in calculating the original land use fee.

*Adjustments Addressing Temporary Hardships Suffered by Homeowners.* As we have noted, CLTs adopt fees that designed to be generally affordable for the income levels they serve. Nonetheless the economic stability of lower income households is vulnerable to a number of possible occurrences, such as unusual medical expenses, temporary unemployment, etc. Section 5.4 of the Model Lease therefore permits temporary reduction or waiver of the lease fee in situations where hardships such as these create unavoidable financial problems for a homeowner.

**Funding a long-term repair reserve.** As noted above, The current version of the Model Lease (in Section 5.1) defines the lease fee as including a “repair reserve fee” in addition to a “land use fee.” In defining the use of the replacement reserve fee, Section 5.1 says only that it is “to be held by the CLT and used for the purpose of preserving the physical quality of the Home for the long term.” The normal expectation, however, is that it will be dedicated to a reserve fund that will be used to cover long-term costs of major repairs to the home or replacement of major components of the home. Section 7.6 of the Model is reserved for provisions relating to the management and use of the reserve, but no one approach to this subject is presented as a model. Questions that should be addressed before deciding on an approach are discussed in the commentary on Section 7.6 presented in Chapter 11-B.

Though somewhat neglected in earlier years of the CLT movement, the question of how to ensure that the necessary resources will be available in the future for major repairs to CLT homes has become a serious concern among CLTs in recent years. It is strongly recommended that CLTs deal with the matter through some form of reserve fund.

It should be noted that in the case of CLT-sponsored condominiums, most if not all of the types of long-term repairs for which funds are normally reserved (roofs, exterior paint, etc.) involve the collectively owned common elements of the condominium rather than the individually owned units. Such reserves are established, held, and managed by the condominium association, though in some cases they may be collected by a sponsoring CLT

as noted below. See Chapter 14, “CLTs and Condominiums,” for further discussion of condominium reserves.

### **Other Lease Fee Considerations**

**Techniques for capturing present value of future lease fees.** In the discussion above we have treated the lease fee as an ongoing monthly charge that can be applied to the CLT’s operating expenses month after month, year after year. At this point we should also note several ways in which the present value of future lease fee income may be captured by a CLT to help in covering immediate project costs. We do not recommend that CLTs pursue these approaches in most situations, since they involve trading away a potentially crucial long-term source of operating support, but there may be some situations involving extremely high land costs, where it makes sense to capture future land use fees to help defray the CLT’s up-front land acquisition costs – at least if there is a realistic expectation that other sources of funding will be available in the future to cover the CLT’s long-term stewardship costs.

*Mortgage-financed lump-sum payment.* It is possible to replace all or a portion of the monthly lease fee (or monthly “land use fee”) with an up-front, lump-sum payment. Since low-income CLT homebuyers normally cannot afford a substantial up-front payment, this approach will require that a mortgage lender be willing to finance not only the purchase price of the improvements but some portion of the mortgagable value of the leasehold interest in the land as a part of the price the homebuyer must pay. (The considerations involved in calculating the mortgagable value of the leasehold interest are discussed in Chapter 20, “Financing CLT Homes.”) At least one CLT has succeeded in arranging such financing to cover a portion of the cost of very expensive land for a subdivision project.<sup>1</sup>

*Lease-fee-backed securities.* Another way in which the CLT may capture an up-front payment for land value is to sell to investors the right to receive the projected stream of monthly payments from homeowners (or that part of monthly payments that is not committed to cover taxes or other direct costs). At least one CLT has realized significant project capital by thus “securitizing” the present value of future lease fees and selling the resulting securities to a bank.<sup>2</sup>

*Borrowing against value of the leased land.* Finally, it should be noted that a CLT may utilize mortgage financing to purchase land with the expectation of using lease fee income to cover its mortgage payments. The practice depends less directly on projected lease fee payments (mortgage payments could be made with income from other sources), but the net effect for the CLT is similar to the effect of those practices that directly commit the land use charge to cover up-front project costs. Again, such practices should be considered only as a last resort in situations where project costs cannot be met in other ways but where there is a realistic expectation of covering future operating expenses from other sources.

**Lease fee concerns relating to federal tax-exemption.** As noted in Chapter 6, “Tax Exemption,” most CLTs qualify for federal tax exemption under Section 501(c)(3) of the Tax Code on the basis that their activities, including the leasing of land, are performed for charitable purposes. Lessees pay for some portion of these activities through the lease fee. In determining the charitable status of CLTs, the IRS is therefore interested in how lease fees are established, how they are subsidized, and who benefits from the subsidy. A subsidized lease fee for a leasehold that does not serve a charitable purpose (either by assisting a low-income household or by serving another charitable purpose as described in Chapter 6) may constitute an

inappropriate use of the CLT's resources and, if found to be a general practice of the CLT, might jeopardize its 501(c)(3) tax exempt status.

We should emphasize that a 501(c)(3) organization is *not prohibited* from leasing land (or selling or renting a home) to higher-income individuals or other non-charitable entities for non-charitable purposes *as long as such lessees pay market-rate fees* for what they receive. CLTs that do lease land for such non-charitable purposes should be prepared to demonstrate that the lease fee has been calculated, on a reasonable basis, as a market rate ground rent. (See the discussion above under "Setting a Fair Charge for Value Received by Homeowner.")

**Lease fees and CLT homebuyer financing.** As discussed in Chapter 20, "Financing, CLT Homes," lenders considering making mortgage loans to CLT lessee-homeowners have several types of concern with the amount of the lease fee. In processing loan applications, they are, first of all, concerned with the fee as part of the borrower's monthly housing cost – along with principal, interest, taxes and insurance – which must be addressed in the underwriting process to determine the affordability of a given mortgage amount. By charging a higher lease fee, a CLT will normally reduce the amount of mortgage debt that will be considered to be affordable (unless the amount of subsidy is increased).

A lender processing a loan request is also concerned with the lease fee as a determinant of the mortgagable value of the leasehold interest in the land, which in turn will affect the loan-to-value ratio for a loan of a given amount. The leasehold interest in the land has mortgagable value to the extent that the fee is less than a market-rate fee would be. A market-rate fee would tend to approximate the amount of monthly mortgage payment that would be required if the homeowner were purchasing the land outright – which would mean, in effect, that the land is already fully mortgaged, with no additional mortgagable value remaining. This matter is discussed more thoroughly in relation to mortgage concerns in Chapter 20, "Leasehold Mortgage Financing."

Mortgage lenders seeking FHA mortgage insurance will have to concern themselves with specific FHA regulations affecting leasehold mortgages. On occasion, these specific provisions have been written into a lease rider to satisfy FHA requirements. (Possible new FHA provisions for CLT leasehold mortgages are currently being discussed with FHA. These may or may not include lease fee provisions.)

Finally, mortgage lenders have an ongoing concern with the fact that a failure by the homeowner to pay the lease fee would be a default under the terms of the lease. To insure against such a default and protect their interest in the leasehold, some lenders require that the lease fee be paid to and escrowed by the lender or servicer of the mortgage, along with the monthly installments of taxes and insurance costs that are typically escrowed in such situations.

**Collecting monthly fees.** A number of CLTs – especially those that primarily serve low and very low income households with little or no previous homeownership experience – have struggled with the challenge of collecting a separate lease fee payment from households accustomed to making only one (rent) payment each month. In these cases, it can be a convenience to both the homeowner and the CLT if a mortgage lender is willing to collect the entire lease fee for eventual payment to the CLT, so the homeowner only has to make one payment each month to cover all basic homeownership costs, and the CLT does not have to make the special effort that may otherwise be required to collect a *second* monthly payment from the homeowner. Other CLTs, however, believe that it is important that they collect

monthly fees directly from homeowner because they don't want to lose the regular contact and communication that the process entails.

For those that do require monthly payment directly to the CLT itself, it is critical that the obligation not be allowed to slide. If a CLT does not appear to notice when fees are not paid when due and does not take firm action to follow up regarding overdue fees, a homeowner will quite naturally assume that prompt payment is relatively unimportant – perhaps less important than meeting other pressing needs that compete for a share of a lower income household's financial resources. CLTs should follow a strict policy of sending a written notice regarding unpaid fees immediately upon the expiration of a "grace period" of a specified number of days. The current Model Lease (in new section 5.7) provides for interest to be charged on unpaid fees beginning on the day the fee is due, but with first-month interest being forgiven if the fee is paid within that first month. For CLTs using this model it is recommended that a "late notice" be sent at least by the middle of that first month to lessees who have not paid. The notice should explain that the "interest clock" has been started but that the interest will not have to be paid if the regular fee is paid before the end of the month. If the fee remains unpaid for more than a month, it is recommended that a second notice be sent, showing the amount due as including the accrued interest, and warning that continued failure to pay can result in a formal notice of default and that, if not "cured," a default can eventually lead to very serious consequences. It is also important, at this point if not before, to try to reach the homeowner by phone or in person to determine whether there is a particular reason why the fee has not been paid. If there is a reason involving serious hardship for the household, such as serious illness or job loss, the CLT may defer the immediate obligation and negotiate a new payment schedule, or, in some cases, may reduce or waive the obligation for some period of time (a possibility recognized by Section 5.4 of the Model Lease).

Finally, if there are no grounds for reducing or waiving the fee and if repeated non-payments accumulate over a number of months, so that a substantial debt results, the CLT may take the homeowner to court to collect what is owed, or may, when the home is eventually sold, collect the amount owed out of the proceeds of sale, as provided in Model Lease Section 5.8, which also provides for a lien on the home to ensure that what is owed will in fact be paid when the home is sold. Legal issues related to such "worst case" situations, and the steps by which they may be resolved, are discussed in Chapter 24, "Dealing with Worst Cases."

**Additions to lease fees.** The total amount of lease fee owed by a lessee at a given time can be increased by several factors.

*Penalties for lease violations.* Some CLT leases include provisions for assessing monetary penalties for non-monetary defaults, i.e. for violations of requirements or restrictions such as the occupancy requirement or use restrictions. These penalties are usually treated as additions to the lease fee, the payment of which the lease specifically requires. They may be assessed as either a lump sum that is immediately payable or as a sum to be added to the monthly lease fee for a specified number of months, or until the violation in question has been cured.

*Other additions to lease fees.* CLT leases generally provide that any amounts owed by the homeowner to the CLT are to be treated as additional lease fee, for which payment is required as a condition of the lease – so that a failure to pay constitutes a default under the lease. The Model Lease specifically provides for addition to the lease fee of interest charged for late payment of fees (Section 5.7), reimbursement due to the CLT for taxes paid on behalf of the

homeowner (Section 6.4), and reimbursement due to the CLT for payments made to discharge liens on the home or leased land (Section 7.4).

**Monthly fees collected for other entities.** In some situations, CLTs also collect monthly payments for other entities that have some relationship to the leasehold in question – such as condominium associations or neighborhood associations to which the homeowner has a necessary obligation. The details of the CLT’s role in collecting such fees – and the specific obligations of the CLT in the event of non-payment – should normally be spelled out in a contract between the CLT and the other entity.

In the case of fees collected for other entities such as condominium associations, it should be understood by all parties that the additional fee is not a *component* of the lease fee; it is established by the authority of the other entity and is owed to the other entity. It is collected by the CLT on the same basis that a mortgagee may collect and escrow the CLT’s own lease fee. There may be other situations, however, where an additional fee is established by the authority of the CLT lease itself – for instance in the case of a CLT-developed subdivision where the creation of a home owners association is dictated by the terms of the lease. In such cases, the HOA fee may (if it is so advised by the CLT’s attorney) be treated as a component of the lease fee.

In agreeing to collect, account for and pass on fees for another entity, a CLT must of course be prepared to accept added administrative responsibilities. Those responsibilities may include at least the initial follow-up steps regarding non-payment discussed above. (Since the other entity’s fee will be combined with the CLT’s lease fee, a failure to pay one will normally mean a failure to pay the other.) However, the CLT should not assume responsibility for paying any portion of another entity’s unpaid fees that are ultimately uncollectable. See Chapter 14, “CLTs and Condominiums,” regarding issues specific to condominium fees.

## Transfer Fees

A CLT’s management of the resale of homes entails significant costs. The revenue stream contributed by monthly lease fees can help to cover these costs, but most CLTs today arrange to receive a separate one-time payment at the time of resale, with the intention of covering some or all of the costs entailed for the organization by the resale. Such payments can be structured in any of several ways.

1. If the CLT exercises its option, takes title to the home and then resells it, the CLT can just mark up the price to the new buyer and take a certain amount of “profit” from the transaction.
2. If the CLT exercises its option and then assigns the option to another buyer, it can charge the buyer a fee for the assignment of the option.
3. If the homeowner sells directly to another qualified household, the CLT can charge a fee (to be added to the price paid by the buyer) for its role in confirming the eligibility of the buyer, overseeing the transaction, and issuing a new lease.
4. If the CLT does not plan to recover its costs from the buyer in any of these three ways, it may charge a marketing fee to the seller (comparable to a conventional realtor’s commission).

The first three of these methods increase the price paid by the buyer but do not affect the amount received by the seller. Only the fourth method would normally reduce the amount that the seller would otherwise receive under the terms of the CLT’s resale formula. (It is possible,

of course, to adopt a resale formula that will increase the resale price by the amount of the “marketing fee,” in which case this fee becomes just another form of transaction fee that is ultimately paid by the buyer.)

No special provision in the lease is needed to establish the possibility of method # 1, as long as the CLT has an unqualified right to exercise a purchase option. If the homeowner has a right to sell directly to a qualified buyer of her own choosing, however, the CLT may *not have* a chance to utilize method #1.

A CLT that wants to be able to use method #2, the assignment-of-option fee, should establish its right to do so in the lease – either specifically as an assignment fee or as a form of the transaction fee used in the case of #3. If the CLT’s right to charge such a fee is not explicitly stated in the lease, a CLT might argue that, since the terms on which it can assign its purchase option are not restricted in any way by the lease, there is no reason why it should not charge a fee to the assignee if it wishes. While this argument might be technically defensible, it should be noted that such a fee will increase the total cost of the home for the buyer and will therefore affect the marketability of the home for the homeowner who wants to sell. If marketability is to be affected in this way, the homeowner should be forewarned that such is a possibility. The possibility of an assignment fee being charged should therefore be stated in the lease.

Clearly, the CLT’s right to use method #3 must be established in the lease. But once established, it gives the CLT a means of recovering costs even if the purchase option has not been exercised. Provision for this most broadly applicable type of transfer fee is included in Section 10.12 or 10.13 (depending on which version of Article 10 is used) of the Model Lease – and is now recommended for all CLT leases.

A CLT’s right to charge the seller a marketing fee (method #4) must be established in the lease if the CLT is to be able to charge such a fee in all resale circumstances. If, on the other hand, the CLT simply wants to *offer* certain marketing services to a homeowner, upon receipt of the homeowner’s notice of intent to sell, a fee for those services might be established through a contractual arrangement at that time. It should be noted that a marketing fee that is charged to the seller and does not increase the purchase option price is likely to have greater negative financial impact on the seller than other types of fees will have on a buyer, since transfer fees that are added to the buyer’s price can normally be financed and will add only marginally to the buyer’s monthly mortgage payments.

The maximum amount that can be charged for any of these types of fees is usually established in the lease, as a percentage of the resale price – usually not more than the percentage that would be charged by a conventional real estate broker for selling the home. The CLT can of course choose, on a case-by-case basis, to reduce or waive the fee to increase the affordability of the resale price.

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<sup>1</sup> OPAL CLT on Orcas Island, Washington, arranged Rural Development financing that covered a portion of the land cost as well as construction costs for new homes.

<sup>2</sup> Jackson Hole Community Housing Trust, Jackson, Wyoming, successfully developed this practice under the direction of then Executive Director Jess Lederman, who had extensive previous experience as a mortgage banker.

## Chapter 14

# CLTs and Condominiums

Since the condominium model is a relatively new form of real estate, and many people are not familiar with the details of how it works, this chapter begins with an overview of the model. Following the overview, the planning issues raised for CLTs that are dealing with condominiums in one way or another are discussed.<sup>1</sup>

### CONDOMINIUM OVERVIEW

Residential condominiums are a unique form of homeownership. While traditional homeownership includes the house as well as the front yard, the garden in the back, and the fence around it all, such is not the case with condominiums. Condominiums are a hybrid between individual and communal ownership. The living spaces, which are called “units,” are owned individually, and the remaining portions of the property, referred to as the “common elements,” are owned in common with other unit owners.

Condominiums can take many physical forms, but are typically characterized by multiple living units under one roof. This familiar style of condominium looks and feels very similar to an apartment building, except that the residents are owners rather than renters. In this arrangement, the unit owner wholly owns the airspace and surfaces within the unit, but the remainder of the property, including the building shell (walls, windows, roof, stairs, utility lines, etc.) as well as areas outside the buildings (yards, parking lots, etc., and, most importantly, the ground itself) is owned in common with other unit owners.

The condominium form of ownership is a statutorily created real property interest, defined and regulated by state statute. Because condominium units are, in many cases, nothing more than airspace, with only an accompanying fractional interest in the underlying land, it is no surprise that condominiums are highly regulated by state statute in order to protect unit owners. These regulations vary from state to state, but can generally be classified as relating to formation, operation, and sales.

**Formation.** Condominiums are created upon the recording of a “declaration” in the land records of the jurisdiction in which the property is located. As the central document in the formation process, the declaration “declares” how the condominium is intended to operate. The person or entity responsible for the creation of this document, and in turn responsible for the condominium, is known as the “declarant.” In most instances, the declarant is also the owner of the property upon which the condominium is to be located. The contents of the declaration are controlled by state statute, but generally include the following:

- *A legal description of the boundaries of the property being submitted to condominium ownership.*
- *The name of the condominium, which must be unique within the state.*
- *A statement as to whether the condominium is newly constructed or is a conversion of existing rental housing to condominium ownership.*

- *A description of the size and boundaries of each “unit.”* The unit boundaries are dependent upon the type of condominium created by the declarant, and may or may not include the exterior structure of the building. (In situations where the declarant wants to sell detached housing but is unable to subdivide the land, or wants to retain control of the land, a condominium commonly referred to as a “shoebox” is created, with unit boundaries defined as the exterior of the buildings.) In any case, the condominium units are treated as real property that may be conveyed and encumbered just like more traditional parcels of real property.
- *A description of all of the “common elements.”* By definition, a condominium must include common elements – those parts of the condominium that are jointly owned by each unit owner on a percentage basis. Most often the percentage owned by a particular unit owner is determined on the basis of the square footage of that owner’s unit, but other ways of determining the percentage are possible. For example, if the condominium includes a swimming pool, each unit owner would probably own an equal percentage of the pool regardless of the square footage of their apartments.
- *A description of the “limited common elements.”* Limited common elements are those common elements that are reserved for the exclusive use of certain unit owners, whereas general common elements can be used by all unit owners. Decks and parking spaces are typically designated as limited common elements. *All of the components of the condominium must be designated as either units, general common elements, or limited common elements.*
- *The allocation of voting rights to each unit.* As with the allocation of interest in the common elements, the method of allocating voting rights is subject to the will of the declarant.
- *The allowed and/or prohibited uses for each unit.*
- *The requirements for amending the declaration.*

In addition to the declaration, there are two other key documents necessary to form a condominium – the plat and the association bylaws. The plat is a graphic depiction of the condominium. Its representation of the unit boundaries/square footage measurements and designation of common elements must be entirely consistent with the declaration. The association bylaws are the rules and regulations for the operation of the association of unit owners. They are discussed in the next section.

**Operation.** The ongoing operation of the condominium is controlled by the association of unit owners, which is organized as a non-profit corporation. The bylaws that will govern the operation of the corporation are recorded along with the declaration. They control the allocation of voting interests to unit owners, the manner in which the board of directors is to be elected and removed, the powers to be held by the board, and the manner in which meetings are to be conducted. The bylaws also define certain operational requirements, including those relating to insurance, maintenance and replacement of the common elements, and the employment of property managers. The money needed to operate and maintain the common elements in the condominium is collected from the unit owners as a monthly assessment. A portion of the money

collected is placed in a reserve account so that, when it comes time to replace the roof or resurface the parking lot, the money is available.

Not all condominiums are controlled by a single association, and not all condominiums are solely residential. In more complex condominium structures, the development may proceed through a series of phases and may provide for a mix of residential and commercial uses. It is not uncommon to see a mixed-use condominium with commercial units at the street level and residential units above. In such structures, the developer will often create an association for each phase or use, with a master association that controls the entire development. Each association would have its own bylaws and each unit would be subject to the bylaws for both the immediate association of which it is a part and the master association.

**Sales requirements.** The sale of condominium units carries with it certain disclosure requirements regarding the status of the condominium and the unit. In most states condominium developers are required to provide potential purchasers with a disclosure statement (also called a public offering statement) containing an estimate of the initial monthly assessments, a reserve study that details the capital improvements anticipated over the next thirty years, and, for condominium conversions, an inspection report that details the current state of the units and common elements, along with any suggested repairs. Sales of units cannot be closed until the disclosure statement is approved by the state and is delivered to the prospective buyer.

**Financing.** Although not regulated by statute, financing is another important consideration. The market for condominiums is often more volatile than for other forms of real estate. Condominium sale prices are often the first to drop in an economic downturn and the last to recover when the economy improves. This fact is closely related – perhaps both as cause and effect – to lenders’ reluctance to finance condominium units as compared with other forms of residential development.

Lenders perceive greater risk associated with communal ownership. Although each unit is separately owned and financed, the value of each individual unit is influenced by the actions of the community. If unit owners default on their monthly assessments, the burden of keeping up with needed expenses is then left up to the remaining unit owners. Over the long run, if assessments are not paid, there will not be enough money to fund necessary capital improvements. If those improvements are not completed when needed, the overall value of the condominium is negatively affected, and lenders face a greater risk of not being able to recoup the value of the loan if the property is foreclosed.

In order to offset these risks, the Federal Housing Administration (FHA), a division of the U.S. Department of Housing and Urban Development (HUD), offers mortgage insurance for condominiums, as for other owner-occupied homes. However, FHA will only insure loans for those condominium projects that have been approved by HUD. The requirements for HUD approval are set forth in HUD Handbook 4150.1. These include, for example, the requirement that at least 50% of the units must be sold before approval can be granted, and the requirement that at least 50% of the units must be occupied by the unit owner, among other requirements. Upon approval by HUD, the condominium is then included on a list of approved projects, which is available on the HUD website.

## CONDOMINIUM PLANNING ISSUES FOR CLTS

The condominium-related issues that a CLT must address depend, first of all, on whether the CLT's goal is (1) to develop an entire condominium project on its own (involving either new housing or the conversion of existing rental housing), or (2) to promote and preserve affordable owner-occupancy for certain (but not all) units in condominium projects that have been or are being developed by other entities. We will discuss these two sets of circumstances separately.

### CLT-Initiated Condominium Projects: New Development

Before considering – or *as* you consider – the questions related to condominium development, you should of course address the fundamental question of whether the condominium model is the best ownership structure for what you want to accomplish. If you are beginning with the basic goal of developing a certain number of homeownership units for households in a certain income range in a certain geographical area, the possible ownership models may include, in addition to the condominium model, traditional houses on separately leased plots of land, or townhouses on separately leased lots (with common wall agreements between adjacent units), or some form of limited equity cooperative (including the possibility of a cooperatively owned manufactured housing park). Your choice among such options will depend on a number of factors, including the following.

- The cost of developable land.
- The size and type of sites available.
- The number of sub-dividable lots and the number of homes that can be created on available sites under local zoning regulations.
- The number of units your CLT has the capacity to develop.
- The amount of time over which development and marketing can be, or must be, spread.
- The requirements of state and municipal laws permitting the various ownership models, and the relative complexity and cost of complying with these laws.
- The relative total costs of developing projects of different sizes involving the different ownership models.
- The relative marketability of different models for the intended clientele in the local market.
- The relative advantages and disadvantages of common interest ownership models (including condominium and coop models) for the intended clientele.
- The capacity of the CLT to provide appropriate training for stand-alone homeownership vs. its capacity to provide appropriate training for common interest ownership.
- The long-term support and stewardship responsibility entailed for the CLT by different models.
- The mix of ownership models in the CLTs existing portfolio, and the extent to which a preponderance of condominiums could pose a long-term risk for the CLT (the future marketability of condos, as noted above, being generally less predictable than that of conventional single-family homes).

**Legal framework.** Since the first state condominium law was adopted in 1960 (in Utah), more or less similar laws have been passed in all fifty states. The basic nature of the model established by these laws, as described above in the “Condominium Overview,” does not differ significantly from state to state, but the details – regarding the exact nature of the ownership structure, the process for creating that structure, and the legal responsibilities of the organization that creates it – these do differ. If your CLT is considering undertaking a condominium project, you should expect to work closely with an attorney who has experience in establishing condominiums under the law of your state.

**Ownership structure and enforcement of long-term restrictions.** Under some state condominium laws, it is possible for a CLT to lease an undivided interest in the land beneath a condominium to each individual unit owner. Such leases can then serve as the vehicle for establishing and enforcing the long-term restrictions that are the particular concern of the CLT – restrictions on occupancy, resale, and permitted financing for individual units – and such leases need not differ substantially from other CLT ground leases based on the Model CLT Residential Ground Lease.

However, in states where unit owners cannot hold an undivided individual ownership interest in the land – where they can have only shared interests as members of a condominium association that controls the land – the CLT cannot use a ground lease as a direct means of establishing restrictions on individual units. In some such situations, if the law does not require the association to own the land on a fee simple basis, the CLT may be able to lease the land to the association, and it may be possible to include in the lease a requirement that the association enforce restrictions regarding the resale, occupancy and financing of individual units. But, even where a CLT does enter into a lease agreement with the association, the usual practice, in the absence of unit-by-unit ground leases, is to rely on restrictive covenants on the individual units as a means of enforcing restrictions on those units.

In most states, however, deed covenants are not as enforceable as ground leases over long periods of time. A few states (currently Massachusetts, Vermont, Maine, Rhode Island, and Oregon) have adopted statutes that specifically permit perpetual affordability covenants. In other states the period of enforceability for all covenant-based restrictions is limited, either by statute or by the common law “rule against perpetuities” (see Chapter 8, “Implementing Restrictions on Ownership”). CLTs considering the use of deed covenants should consult with an attorney regarding this aspect of the law in their own states, and should explore the possibility of pursuing legislation similar to that enacted in the five states mentioned above. The statute recently enacted in Oregon – ORS 456.270 et seq – can be viewed at <http://landru.leg.state.or.us/ors/456.html>.

**The CLT’s responsibilities and concerns as “declarant.”** If a CLT is to be the entity that records the “declaration” that brings the condominium into being and describes its essential features, it should be sure that it has a clear understanding of the legal requirements that must guide it in preparing the declaration and in carrying out its responsibilities as “declarant” – that is, its responsibilities up until the time when an elected board of directors assumes responsibility for governing the condominium. The basic types of information that must be included in the declaration are outlined in the “Condominium Overview” above, but, again, it will be important to work with an

attorney who is familiar with the responsibilities specifically assigned to the declarant by your state's condominium law.

It is also important, however, for the CLT to understand not only the *legal* issues entailed in developing the declaration but also the *practical* issues involved in implementing the plans embodied in the declaration. For this reason, it is advisable to seek advice not only from attorneys but from people who have professional property management experience with condominiums. Before you file a declaration it is a good idea to ask such a person to review the document with an eye for any management problems that it might present.

As a provider of affordable homeownership opportunities, a CLT has a particular concern both with establishing condominium systems that will work effectively, over the long term, for its intended lower income clientele, and with preparing these lower income homeowners to work effectively within these systems. The CLT's role in drafting bylaws – and, to varying degrees, in drafting the declaration itself – will be crucial in shaping these systems. The practical considerations involved in drafting bylaws are discussed later in this chapter.

**Responsibilities as developer.** In addition to the responsibilities specific to the role of the condominium declarant, a CLT that is creating a new condominium will have all of the considerable responsibilities specific to the role of the developer of a multi-unit housing project – unless this role can be assigned to or shared with another entity (and even then the CLT must oversee construction closely enough to ensure that purchasers of the units will get the quality that they pay for and that the law requires).

**Permitted uses and income levels.** Among the essential questions to be addressed in planning a condominium project is the question of whether all of the units will be subject to the same kinds of restrictions. If the project will include units intended for commercial or other nonresidential uses, they will necessarily be treated differently from the residential units. The specific uses of nonresidential units will normally be restricted in certain ways – at least for the purpose of ensuring that their use will not negatively affect the residential use of other units, and perhaps for other purposes as well – but the specific nature of these use restrictions will be different from one situation to another. The *resale* of these units may also be restricted, or may not be restricted at all. You may want to allow for-profit businesses to sell their units to whomever they choose, for a market price; or – if your goal is to provide affordable space for nonprofit facilities or for business ventures by local people – you may want to restrict both price and buyer eligibility (but not in the same terms as the residential units). You may also want to consider the possibility of creating separate condominium associations for residential and nonresidential units, since the concerns of these two types of owners will be quite different. (See Chapter 16, Non-Residential Ground Leases,” for discussion of CLT restrictions on non-residential use.)

With regard to residential units, the first question will be whether buyer income requirements for all units will be the same (for instance, requiring all buyers to have household incomes below 80% of AMI) or whether different units will be designated for different income levels. If different income levels are to be accommodated, the question then will be whether all units will be subject to the same resale formula (though with differing prices and buyer-eligibility requirements), or whether there will be some “market-rate” units that have no resale restrictions at all. If there are to be market-rate

units, and if they are physically separate from the “affordable” units, then some CLTs may want to consider creating separate associations for the two types. Generally, however, the creation of multiple associations entails practical disadvantages – including greater initial cost and greater management complexity over time. Furthermore, there are reasons to avoid formal distinctions that would tend to separate members of the community on the basis of their incomes.

In planning mixed-income projects, CLTs should also be mindful of how the particular mix of incomes might affect the organization’s 501(c)(3) charitable status under the terms of the “safe harbor guidelines” or related “facts and circumstances” as published by the IRS. (Projects developed through an acknowledged relationship with a local government agency to serve a higher range of incomes may qualify as charitable on the basis that they “lessen the burdens of government.” In any case, see Chapter 6, “Tax Exemption.”)

**Governance .** As noted above, one of the important concerns for a condominium declarant will be the task of drafting the bylaws that will determine how the condominium association will govern its affairs. The specific content of the bylaws will vary depending on a number of factors – including the particular mix of uses and income levels, as discussed above, the overall number of unit-owners involved, and the particular nature of the general common elements and limited common elements that must be overseen collectively. In any case, however, the bylaws should facilitate effective, stable operation of the condominium under a governance system that is inclusive and democratic. To this end, a CLT should pay particular attention to the following basic concerns.

- *Keeping the governance process as simple as possible.* Complex layers of requirements and restrictions deriving from different associations and stated in different documents can greatly increase the difficulty of self-governance for condominium residents – especially lower-income residents who are likely to have relatively little experience with, or little time to deal with, such matters. Bylaws should not be so simplistic that they fail to provide guidance on important questions, but neither should they be so complicated that just a few members achieve undue power by virtue of being the only ones who understand them.
- *Weighting of votes.* In electing board members, it is common for the vote of individual unit-owners to be weighted according to the size or other differences among their units. For instance, if the home of Owner A is 20% larger than the home of Owner B, Owner A’s vote might have 1.2 times the weight of Owner B’s. Before establishing any such system in the bylaws, however, a CLT should consider the extent to which it may concentrate power in a particular sub-group within the association.
- *Possible direct role of the CLT in governance.* Some CLTs have developed condominium bylaws that give the CLT itself an ex-officio seat on the association board of directors. Also, some CLTs retain permanent ownership of certain units in order to make them available as rental housing for people with special needs or for other specialized uses – which gives the CLT a right to vote as a member of the association, though not necessarily a seat on the board. These opportunities to participate in the affairs of the association give the CLT an opportunity to

monitor, and perhaps to influence, the decisions of the membership and the board. However, the advantages of this potential influence should be balanced against the possible disadvantage of the board becoming over-reliant on the CLT for guidance.

- *Representation of owners of price-restricted units.* In mixed-income projects where lower income residents own units that are subject to occupancy and resale restrictions while higher income residents own “market-rate” units, the CLT has reason to be concerned with the relative influence of the two groups within the board of directors. You may want the bylaws to provide for a certain minimum number of directors to be elected by and from each of these categories, to ensure that the differing interests of the two are both represented on the board. However, you should balance the potential benefits of such representation with the potential disadvantages of the emphasis it places on the differences between the two groups of residents.
- *Affordability of assessments.* The condominium association’s board of directors will have the authority to assess fees to pay for the maintenance, repair and replacement of common elements, and perhaps also to pay for additions and improvements to the common elements. In mixed-income condominiums, fees that are affordable for higher income residents may not be affordable for lower-income residents. A CLT should be sure that the more affluent will not have the power to impose unaffordable fees on the less affluent. This is of particular concern when there are just a few affordable units within a predominantly market-rate condominium project. One way to protect the less affluent is by seeing that they are adequately represented within the board, as noted above, but other measures may accomplish the same purpose. For instance, you may require that replacements and repairs be accomplished with materials of comparable quality to the original materials rather than allowing more expensive materials to be substituted. You may also consider requiring a super-majority vote for improvements that will increase monthly fees by more than a specified percentage, or that would be considered luxuries. And in any case you should do everything possible to ensure that adequate reserves are maintained so that there will not need to be a sharp increase in fees as replacements and repairs eventually become necessary.
- *Access to information.* All association members should have full access to information about the condominium’s financial condition and about all board decisions. The bylaws should require that financial reports be distributed to association members periodically, and that minutes of board meetings also be distributed.
- *Approach to management.* If a contract with a professional property management company can be affordable for all of the unit-owners, a CLT may draft bylaws that require the association to contract for such services in order to assure sound management practices (see the following discussion of management issues).

**Ongoing management concerns.** For the long term, the successful management of a condominium project depends not only on the ability of individual households to manage the practical and financial concerns related to their units but also on the ability of the

association to manage the shared concerns of the community. Central to these concerns is the maintenance of the condominium's common elements. Effective maintenance of these elements is dependent on effective financial management.

The common elements include a number of things that call for ongoing, month-to-month maintenance: lawns that need to be mowed, driveways and parking areas that need to be maintained and, in many locations, kept free of snow, heating systems that need to be fueled and serviced, lighting that must be kept functioning, and so on. All of these activities involve financial obligations that must be anticipated and paid for through monthly fees. The board of directors is ultimately responsible for setting these fees, but should do so based on accurate information and calculations provided by managers.

It should be noted that not all unit owners should necessarily be assessed the same amount. It is appropriate for unit owners to share some expenses equally (such as the cost of lawn mowing or heat for common areas to which all have access), but other expenses may be more fairly charged to unit owners on a different basis. For example, if heating costs for living units are included in the assessment, owners of larger units should pay a larger share of the cost. Similarly, owners of units with 3 bedrooms and 2 bathrooms should pay a larger share of a water bill paid out of the assessment than owners of units with only a single bedroom and bathroom. And, in a multi-building development, the expenses of maintaining common space in a particular building may be charged only to the owners of units in that building.

**Long-term financial management.** There will also be long-term costs that will not require monthly, or even annual payments but that will require payment of substantial sums at a future time. These include such eventual necessities as painting the exteriors of buildings, replacement of roofing, and the repair or replacement of major components of heating, cooling and ventilation systems – all of which are the responsibility not of individual unit-owners but of the association. It may be tempting to ignore the fact that such costs are out there in the future – especially for a new condominium with brand new facilities – but it is extremely important that they *not* be ignored.

Sound management requires that both the probable timing and the probable amounts of long-term costs be anticipated, and that reserve funds be established and funded at a level sufficient to cover the costs when they must eventually be paid, without need for large increases in monthly fees at that time. Maintaining sufficient reserves is *especially* important when the goal is to preserve the affordability of units for future lower income owners. The failure to assess current owners sufficiently to cover long-term costs (which accrue for both initial and later residents) will shift the burden of these costs to future owners – including lower income households for whom that burden may be unaffordable.

To the extent that reserves can be funded at the outset as a subsidized part of the CLT's overall development cost, the financial burden for both present and future owners may be lessened. Over the long term, however, the reserves must be funded primarily through the fees paid by the members from month to month.

**Essential financial management tasks.** If all costs – both short- and long-term – are to be covered systematically, a number of essential tasks must be completed.

- All basic operating expenses must be identified and total annual operating expense projected.
- Any debt service obligations must be identified month by month and year by year.

- Capital needs assessments must be conducted to determine the likely amounts and timing of future capital costs, and the amounts that will need to be reserved in order to cover these costs.
- The monthly fees necessary to cover all operating expenses, debt service, and the funding of reserves, must be calculated and allocated fairly to the members.
- Systems should be established for the collection of monthly fees and for consistent follow-up regarding late payment.
- Realistic annual budgets must be developed for board approval.
- Month-by-month cash flow projections must be made to evaluate the likelihood that enough cash will be available *when* it is needed.
- Bank accounts must be established; procedures must be established for deposit of all receipts without delay and for making all necessary disbursements before penalties are incurred.
- A proper bookkeeping system should be established and implemented consistently.

All of these tasks should be carried out in the context of a fully developed accounting system that will yield verifiable financial reports to the board and the membership of the association at regular intervals.

**Who will carry out management tasks?** As the governing body of a condominium association, the board of directors is responsible for seeing that the association is well managed, but it should be emphasized that governance and management are not the same function. It is the board's job to set policies, approve budgets, and (except in the case of some small condominiums, as noted below) to hire managers. It is then the managers' job to implement policies on a day-to-day basis and see that the association's duly established policies are consistently implemented and that its financial transactions are carried out in accordance with its duly approved budget. In general, the board of directors should not try to micromanage the association's day-to-day business, and the professional managers should not intervene in the policy-making functions of the board of directors.

The preferred way of ensuring that essential management tasks are carried out satisfactorily is for the association to contract with a professional property management company (either for-profit or not-for-profit). For smaller projects, however, the per-unit cost of professional management services may be more than is affordable for lower income households. In such situations, self-management is an option to be considered, at least if adequate management training can be provided to the association's board of directors, or to a committee of the board that will be charged with day-to-day management responsibilities. At least one CLT – Champlain Housing Trust – has developed smaller condominium projects that have successfully managed their own common property (with the help of a paid bookkeeper).

Another question that may come up – at least in the case of self-managed condominiums – is that of the CLT's long-term role in seeing that the condominium is properly managed. Should the CLT have a monitoring and advisory function? Should it have a right (if legally possible) to approve or disapprove major decisions affecting management? If it has management capacity in its own organization, should it perhaps provide management services (or some level of management oversight) to the

condominium? Or should it adopt a hands-off policy but be prepared to intervene if there appear to be management problems? CLTs have differed significantly in their approach to these questions.

Northern California Land Trust's condominium lease (leasing an undivided interest in the land to each Homeowner) calls for CLT approval of reserves and assessments, contracts with property managers, and rules enacted by the Association. At the other end of the spectrum, Champlain Housing Trust, an experienced property manager in its own right, has generally followed a hands-off approach, though it does provide training and technical assistance during the time when new condominium boards of directors are establishing management systems, and does maintain a certain level of contact through its role in collecting fees and overseeing resales of units.

**Initial orientation and training of condominium purchasers.** Whatever its ongoing role in relation to the condominium association and its board of directors, the CLT should normally play an active role in orienting and training the individual condominium purchasers – both at the time units are initially sold and as they are resold over time. The kind of training needed will include not only many of the elements that are important for first-time buyers of conventional homes, but also preparation for the role of association member. Among the things that are important for association members to understand are:

- The basic condominium ownership structure: who owns what – individual units, common elements, limited common elements, the fee interest in the land;
- the rights and responsibilities of members of the association;
- the process of electing the board of directors and the powers and responsibilities of the board as established by the bylaws of the association;
- basic financial management concepts needed to understand the management of the association's affairs by the board and/or management company (including an understanding of the purpose of reserves and a basic understanding of financial reports);
- the rules and regulations established for unit-owners by the board;
- the role of the CLT and the nature of the resale (and other) restrictions it is charged with enforcing.

The exact nature of the training will vary, depending on the specific features of the state condominium law and the terms of the declaration and bylaws as well as on the size and nature of the project. The PowerPoint presentation entitled Homeowners Association 101, developed by the City of Lakes CLT, provides an example of one kind of introductory training for condominium association members.

### **CLT-Initiated Condominium Projects: Conversions**

Condominium conversion projects entail the conversion of rental housing to condominium ownership. The rental housing may have been originally developed by a CLT that later decides that owner-occupancy would now be desirable and possible, or it may be a rental project that the CLT has decided to acquire with the intention of converting it to condominium ownership, perhaps with plans to improve the quality of the housing in the process. In either case the CLT will not only need to deal with all of the important issues that it would face as the developer of a new condominium project, but will also need to deal with an additional layer of issues arising from the fact that the form

of ownership – and all that it entails – will be changed for *existing* residents of the housing.

In the for-profit world, a condominium conversion may happen when a landlord sees it as a way of liquidating a rental property on favorable terms (converting a stream of rental income into capital that could be invested more profitably elsewhere). Or it may happen when a developer sees an opportunity to acquire depreciated rental property, improve it, and sell it, unit by unit, for a profit as condominium property. For a CLT, however, the overriding concern will not be profit; it will be the question of what costs and benefits a conversion would yield for the residents (though the costs and benefits for the CLT itself are of course also relevant).

**Critical preliminary questions.** To assess both the costs and benefits for the residents and the workability of a condo conversion for everyone concerned, some important questions must be carefully explored.

- How many of the current tenants have an active (or at least potential) interest in owning their current home as a condominium unit?
- Does the property need rehabilitation? Is there interest among residents in seeing it rehabbed – or perhaps improved beyond its original condition?
- How much debt does the CLT already carry for the housing in question (or, if it does not already own it, how much debt would it have to assume to acquire the property). How much would the cost of conversion add to this existing debt – including potential rehab costs, legal and administrative costs, and the cost of organizing and training the residents?
- What are the incomes of current residents? How many could qualify for mortgage loans – and for what dollar amount? How many would qualify for public subsidies? Given the total cost of the project, how many resident households would be able to finance the purchase of their units with the help of any subsidies they may qualify for?
- For those who are either not interested or not financially able to purchase their unit, what are the alternatives? Additional subsidy for purchase? Continuing rental within a condominium? Relocation? How well would these alternatives work for the residents, and how would they affect the condominium if a conversion takes place?
- In your jurisdiction, what will be your CLT's specific obligations to the current residents (in addition to other obligations as declarant) during the conversion process? (For instance, in some states, existing residents in a rental property must be given the first opportunity to purchase their apartment if it is converted to a condominium.)
- Is there – or can there be – enough sense of community among the existing residents to foster the development of a successful common interest community?
- For both the short and long term, how marketable will units be to people who do not already live in them?

**Initial outreach and organizing.** Thorough exploration of most of the questions above will require a substantial amount of interaction with the residents, before as well as after a decision is made to proceed with a conversion. The needs and interests of the residents

will need to be surveyed, and should also be discussed in groups sessions, where residents will have an opportunity to respond to the asserted needs and interests of their peers and where CLT personnel will have an opportunity to assess the level of agreement among residents and the group's potential for cooperation.

Transparency is critical to establish trust. Clear information about the nature of a possible conversion should be made available to residents of all units, and group sessions should be scheduled to allow for discussion of the subject, and to answer any and all questions. As planning progresses, CLT personnel should meet individually with all resident households to address their concerns and to begin the process of assessing their ability to qualify for mortgage financing.

In so far as possible, resident input should be invited regarding rehabilitation and improvement of the property. Resident input can also be important regarding the drafting of the bylaws that will shape the condominium's governance structure.

Clearly all of this will require a substantial amount of time, and a substantial amount of staffing. Conversions of larger rental projects may call for the full-time efforts of at least one organizer for at least a year. The costs of such staffing should be realistically anticipated in developing a conversion budget

**Counseling and training.** Residents who want to purchase their units will need varying amounts of counseling to help them qualify for mortgage financing. Any residents who cannot or do not want to purchase their units will need varying amounts of counseling to help them make alternative arrangements.

Training to prepare residents for the role of association membership will be as important for conversions as for newly developed condominiums. The list of basic training topics that appears above in connection with newly developed condominiums can be applied to conversions as well. For conversions, however, this kind of training can begin sooner – perhaps at the same time that bylaws are being drafted and other aspects of planning are moving forward – since most of the residents will be present well before the condominium is actually created and units are actually purchased.

### **Condominium Units in Projects not Developed by the CLT**

**Two types of situations.** CLT stewardship of condominium units located in projects that have not been developed by the CLT itself can be a product of two different kinds of situations:

1. *New condominium projects in which a limited number of the units will be offered for affordable prices with resale price restrictions.* Such projects may result from municipal inclusionary zoning ordinances – and/or project-by-project agreements between municipalities and developers – requiring that a certain percentage of new units be “permanently affordable.” Such projects may also result from an agreement between a CLT and a developer, with the CLT agreeing to contribute public subsidies available to it for a certain number of units (e.g., the condominium projects of the City of Lakes CLT and Kulshan CLT).
2. *Scattered-site “buyer-initiated programs.”* In these programs, a CLT applies available public subsidy to the purchase of a home (condominium or other) selected by the buyer from among units that are for sale in a designated market and that have been approved by the CLT.

In all of these situations, a CLT's relationship with a unit-owner is on a unit-by-unit basis – through a covenant attached to the deed to each unit – but this does not mean that the CLT can disregard the many issues that relate to the condominium as a whole. In the case of a new condominium that a CLT has not initiated but in which it will steward a certain number of units, the CLT will still have the same concerns discussed above in connection with CLT-initiated projects. It will still want to be sure not just that individual units are appropriate for the individual households but that the condominium as a whole will work – on an ongoing basis – for lower-income residents in terms of physical structure, governance structure, financial structure and management structure.

The same is true for condominiums in which a CLT may consider subsidizing and stewarding one or more units through a buyer-initiated program. When a CLT evaluates a single-family detached home for possible purchase through a buyer-initiated program, it can focus primarily on the home itself, independent of its neighbors, but when a CLT evaluates a condo unit for such a program it must look at the whole condominium project. If the condominium has been operating for some time, there will be a need – and opportunity – to look not only at the way the project was planned but at its actual performance. Are buildings and grounds well maintained? Are financial reports up-to-date? Are finances stable, with reserves being funded at appropriate levels? Has occupancy been stable, with limited vacancies?

**Monitoring and stewardship fees.** In the case of “inclusionary units” (whether as products of zoning ordinances or project-by-project agreements), it has been common for municipalities to record deed covenants restricting the occupancy and resale of the units for an extended period of time. In the past, these municipalities rarely provided for monitoring and enforcement of the restrictions. It was assumed that the covenants would be “self-enforcing” – i.e., when a resale was pending, the buyer's attorney (or an attorney for a lender or title company) would discover the recorded covenant and would avoid a violation that would undermine the buyer's title.

Over time, however, it became clear that affordability covenants were self-enforcing only to a limited extent (see Chapter 8, “Implementing Restrictions on Ownership”), and for this reason it is increasingly common for CLTs to be asked to take on a stewardship role for such units, with responsibility for monitoring compliance with the restrictions and assuring that when the units are sold they are sold to households in the designated income range for prices that do not exceed the limits established by the covenants – and assuring as well that a similar covenant is attached to each buyer's deed. Such covenants are normally framed as a transaction or agreement between the unit-owner and the CLT – with the CLT defined as the source of the benefits of affordability and the unit owner, in return for these benefits, agreeing to accept the restrictions and granting the CLT the right to enforce them.

The CLT usually charges a monthly “stewardship fee” to the unit-owner, which helps to cover the cost of monitoring and provides for month-to-month contact with the owner as a basis for monitoring continued occupancy. The fee is not a lease fee like that which may be charged when a CLT owns the land beneath a home, but is justified as part of the bargain that includes subsidized affordability for the owner. Typical fees range from \$25 to \$50 per month.

**Marketing and buyer-orientation.** The extent to which a CLT controls the marketing of inclusionary units varies from program to program. In some cases the CLT may be *the*

entity that markets the units; in other cases it may have limited control or may share control with the developer and/or the subsidy source and/or professional realtors. In the case of scattered-site buyer-initiated programs, the CLT normally will not be actively involved in marketing condominium units but, as emphasized above, can and should screen the available units *and* the condominium projects in which they are located, and should communicate its assessment clearly to potential buyers. In any case, the CLT should play an active role in orienting, qualifying, and training buyers with regard to the terms of the covenant and the relationship with the CLT.

**Matching buyers with appropriate condominiums.** A municipality that creates inclusionary units may, in the process, influence the structure and policies of a particular condominium project, and a CLT, as the municipality's partner in preserving the affordability of these units, may have a degree of influence on the project. But this influence is likely to be limited at best. In its unit-by-unit condominium work, the CLT will be involved, as a general rule, not with shaping the projects in which the units are located, but with seeing that the homebuyers buy units in existing condominiums that will meet their needs and allow them to succeed as homeowners and as members of the community. This "matching" function is especially important with buyer-driven programs, where a variety of different condominiums may offer possibilities for CLT homebuyers.

In addition to the questions that CLTs must consider when matching buyers with any type of housing (affordability of initial price, number of bedrooms, location and availability of services, etc.), CLTs matching buyers with condominium units must also consider the affordability of monthly fees, the sufficiency and maintenance of common areas, the sufficiency of financial reserves and financial management practices, and the appropriateness of governance structures for inexperienced lower income unit-owners.

**Assessing long-term affordability and marketability.** An immediate concern will of course be the overall affordability of the unit – not only in terms of the purchase price but in terms of the ongoing monthly fees that must be paid to support the costs of maintaining the common elements of the condominium. It should also be recognized, however, that these monthly fees will increase over time to the extent that the association's operating costs increase.

In a condominium project where low-income households are a minority of the condo owners, there is a particular concern that the members of the association may vote to approve expensive improvements that would increase members' monthly costs beyond what the low-income members can afford. Before helping low-income people to buy units in a particular condominium, a CLT should review financial management practices, including actual reserve levels, and bylaws provisions in an effort to determine the likelihood and possible timing of fee increases, and should be sure that the incomes of purchasers will provide enough "cushion" to absorb possible increases.

Regarding resale, the CLT must concern itself not only with the future affordability of the unit for the intended income level but with its marketability in a range of different market conditions. (See the discussion of affordability and marketability in Chapter 18, "Project Planning and Pricing.")

If the CLT's involvement is through a "buyer-initiated program," then, before designating units as eligible for the program, the CLT should screen them to be sure they are appropriate in all respects – including probable future as well as present affordability

and marketability – for a reasonable range of households in the targeted income range. In the realm of “permanently affordable” homeownership, it is not enough simply to make the present match between a unit and one particular household.

Finally, as noted in the “Condominium Overview” above, the market values of condominium units tend to be more volatile than the values of single-family detached homes. When demand for condominium units slackens in a particular market, their value may drop significantly – perhaps eliminating much of the market advantage originally created by a subsidy. If a high percentage of a CLT’s holdings consists of condominium units, the organization can face serious problems in such a market situation. For CLTs working in very expensive markets, there may be little alternative to the condominium model as a means of providing affordable homeownership opportunities for lower income people, but CLTs that do have some choice regarding the ratio of condo to non-condo units in their portfolios may want to limit this ratio – or at least keep an eye on it – in order to limit their exposure to weak market conditions.

#### **A Note on FHA-Insured Financing for Condominium Units**

As is emphasized in the “Condominium Overview” above, the availability of FHA mortgage insurance for loans to condominium purchasers has played an important part in assuring lenders that loans for this new form of property are not unduly risky – even though the collateral is, physically, just a “box of air.” CLTs should be aware, however, that there have been some serious problems regarding the use of FHA-insured loans for the purchase of resale-restricted homes (as discussed in Chapter 20, “Financing CLT Homes”), both for conventional single-family homes and for condominiums. Possible solutions to these problems are currently being discussed between CLT Network personnel and FHA officials. For up-to-date information contact NCLTN.

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<sup>i</sup> This chapter was drafted based on extensive input – through a number of conference calls – from a group of attorneys and practitioners working with CLTs that have experience with condominiums. The section entitled “Condominium Overview” was drafted by attorney Jeff Evans, a member of the group.

## Chapter 15-A

# CLTs and Limited Equity Housing Coops with Model CLT-Coop Lease

### Introduction: Why the Combination of CLTs and Coops

For some time, supporters of the community land trust model have harbored a sympathetic interest in limited equity housing coops. In 1984, the Institute for Community Economics published an essay entitled “Limited Equity Coops and CLTs,” in which the following paragraph appeared:

As participatory community-based models providing access to land and housing for lower income people, CLTs and limited equity coops each offer an alternative to unrestricted individual ownership and the private market on the one hand and government ownership on the other hand. Both give people the security that comes with control of their own homes, while limiting the transfer of property in the marketplace to keep it affordable for lower income people in the future. Both attempt to balance individual and community interests – promoting economic justice for individuals while retaining for the community the “social increment” in the property used by the individual.<sup>1</sup>

The essay went on to note the essential difference between the two models – coops being controlled by the residents of the housing, CLTs being controlled by memberships that include both those who live in CLT housing and others in the community who do not live in that housing – but then emphasized that the two models were complementary in certain ways. In fact, it stated, “. . . we at ICE have been interested in the idea of a relationship between a CLT and limited equity coops within a community: the coops owning and managing housing on a limited equity basis; the CLT owning the land under the coop housing. . . , linking scattered coops and other neighborhood development in a stable network, and reinforcing the coops’ equity limiting provisions. . . .”

This vision of a CLT-coop relationship resonated with the founders of early CLTs, who recognized the advantages that both types of organizations might gain by working together. It was clear that coops owned and controlled by low-income people with limited resources and limited experience in managing real estate were economically vulnerable, and it made sense that they could be strengthened by a relationship with a CLT. It was also a known fact that the members of some limited equity coops that *had* succeeded in rapidly appreciating real estate markets had succumbed to the temptation to amend their bylaws to remove equity limitations so that they could sell their shares for unrestricted market prices. It was understood that a CLT ground lease – had the coop been leasing the land from a CLT – could have prevented this.

CLTs also saw coops as a possible solution to a problem that many of them confronted. CLTs working in low-income communities were typically trying to do two things that were not easily done together. They were trying to acquire and rehabilitate run-down absentee-owned rental housing, often in two-to-six unit buildings. At the same time they were trying to create ownership opportunities for the low-income life-long

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<sup>1</sup> “Limited Equity Coops and CLTs,” *Community Economics*, Number 4, Spring 1984, Institute for Community Economics, Greenfield, Massachusetts.

tenants living in those buildings. For those tenants, coops seemed to be the only form of resident-ownership that was feasible.

### **What Does it Take to Create a Successful Coop.**

In the later 1980s and early 1990s, a number of CLTs did organize coops to own buildings of this sort on CLT land. Some of these coop projects were successful, but there were also a number that did not succeed and were eventually converted back into CLT-owned rental properties. No one quality clearly distinguishes those that succeeded from those that did not succeed, but CLTs now have enough experience with coops in a variety of different situations to make some useful generalizations about the conditions that will *favor* success.

**Commitment to coop model.** Coop membership entails not only certain benefits but certain responsibilities – and therefore a certain kind of effort – that conventional tenancy does not entail. If the members of a coop are committed to the model and determined to make it work, their coop probably will work. If they would really rather be conventional tenants and let a conventional landlord bear full responsibility for managing their housing, then it is unlikely that a CLT – or any other would-be coop organizer – will be able to create a successful coop.

The biggest problem that a number of the early CLT-initiated coop projects faced was that the projects were identified in terms of the condition and market status of specific buildings rather than in terms of groups of people actively interested in coop membership. It was assumed that the existing low-income tenants of those buildings could benefit from cooperative ownership, but the tenants themselves had little or no knowledge of housing coops and little reason to commit themselves to forming a successful coop. They were grateful that a nonprofit organization was acquiring and improving their building, and they might say “yes, cooperative ownership sounds great,” but this sort of acquiescence is not the same as commitment to do whatever it takes to make cooperative ownership work.

**Training, guidance, and support.** Even when there is some level of commitment to the coop model, new members or potential members cannot be expected to bring with them the knowledge and skills needed to make the coop work. Training is essential if the necessary knowledge and skills – relating to everything from the governance process, to physical maintenance and financial management – are to be developed. Training is needed for all members of a new coop, and for new members who come into the coop later on. And a certain amount of *ongoing* training, guidance and support is also needed. A CLT cannot expect that, after a few initial training sessions, a group of people who have probably been tenants all their lives will suddenly have all the knowledge and skills needed to work together to manage their housing and deal with any and all problems that may arise.

Successful CLT-related coops have generally had the benefit of a regular ongoing supportive relationship, if not with the CLT itself then with a separate coop federation, mutual housing association or other such entity. The successful coop-related experience of Champlain Housing Trust (formerly Burlington [Vermont] CLT) is instructive in this regard. Like some other CLTs in the later 1980s it had undertaken the rehabilitation of a number of two-to-four unit rental properties, with the intention of eventually converting as many of them as possible to cooperative ownership, and like those other CLTs it was

finding it difficult to make such conversions actually happen. Unlike those other CLTs, however, it received help from a municipal government that was itself committed to promoting successful coops. The city of Burlington took the initiative in forming and funding the Champlain Mutual Housing Federation to organize and train coops that not only would own CLT (and other) buildings but would have certain reporting obligations and would receive certain kinds of guidance and support as members of the Federation. At a later time the Federation was folded into the CLT itself, which continues to provide guidance and support to its coop lessees through contracts for services.

**Shared “culture.”** Within a coop, responsibilities must be shared. Members must work together effectively. It will be easier for them to do so if they have interests, beliefs, or experience in common. One example of shared interests and beliefs is of course a shared commitment to the coop model, as noted above. But other kinds of shared experience can also facilitate cooperative efforts. One of the successful coops developed by Champlain Housing Trust involves a “live-work” facility that provides work space as well as housing for a small group of artists and craftspeople. Members of this group obviously have more in common than do the residents of most apartment buildings. In another successful but very small CHT coop (just four units), all the member households are independent small-scale farmers, working near each other on land just outside of Burlington.

Another important kind of shared experience for some coop memberships is provided by the process of planning and creating the coop – and in some cases by the shared experience of creating the housing itself. The four successful coops developed by Lopez CLT (on Lopez Island in Washington State) have clearly been strengthened by the fact that, in each case, the members participated together in the lengthy process of building a cooperatively owned cluster of single-family homes. It should also be noted that the various kinds of shared experience in planning and creating a coop and/or coop-owned housing has not only a bonding effect on the membership but also a self-screening effect. Some of those who begin the process may discover that, for one reason or another, they are not comfortable working with the group – in which case they can depart and be replaced by others before the coop begins operating.

**Advantages and disadvantages of smaller size.** There is no one ideal size for all situations. It is true that small coops can be less durable over time than larger ones. If a coop has only four members and one of them moves out and must be replaced with someone who has no previous coop experience and no history with the group, the effect can obviously be destabilizing. And *continued* turnover at even a modest rate in such a small coop can be a potentially unsupportable burden. Yet there are also advantages to small size if other positive factors are present. In fact most of the successful coops mentioned above – including CHT’s four-member coop and the Lopez Island coops (whose memberships range from seven to eleven households) – are small. As we have said, these coops are notable for the extent to which their members are brought together by shared experience. It would be difficult to find this degree of shared experience in much larger coops.

Small coops also enjoy an advantage in so far as self-management (the members themselves carrying out management tasks) is a goal. Self-management is a necessity for very small coops, which normally cannot afford professional property management. In the view of some, self-management is a desirable feature of a true cooperative. In other

words, self-managed coops are more clearly distinguished from the conventional rental situation, where the housing is managed by someone other than the residents. At the same time, it cannot be denied that small coops managed by members with limited management experience are vulnerable to mismanagement. Training, guidance and support from a CLT or other entity are especially important for these coops.

**Advantages and disadvantages of larger size.** Larger coops – and there are many with more than 100 members – have the advantage of being less affected by the transfer of units to new members. A 100-member coop would need to have 25 units transfer all at once if it were to have the same ratio of new to old members as a 4 unit coop where a single unit has transferred. There are also economic advantages for larger coops in so far as self-management is *not* a goal. Such coops can afford to contract with professional property managers. In fact, for very large coops this arrangement is likely to be the only realistic option, since self-management by a large group becomes a very complicated process.

Professional management should substantially reduce the potential for mismanagement of the physical and financial aspects of a coop's housing. As we have noted, however, it is also very similar to conventional rental housing in some respects. The members still have ultimate control over how and by whom their housing is managed. They (or the board of directors they elect) have the power to hire and fire property managers, approve or reject proposed budgets, etc. But it is common for members of large coops to disengage from property management issues to a greater or lesser extent, and in doing so to treat their housing situation as though it really were no different from a rental situation. Members of these coops may not need exactly the kinds of management training that members of small self-managed coops need; nevertheless, if they are to have meaningful control over their housing, they – or at least a substantial portion of them – do need training and guidance relating to the not-so-simple process of directing, overseeing, and evaluating the work of professional managers.

## Varieties of Coop Structures

The basic considerations discussed above apply more or less equally to coops structured in different ways. Nonetheless, coop corporations, and the rules that govern them, can take different forms, and these differences will have consequences that a CLT interested in creating a housing coop must consider. In this section we will look at the difference between (1) coops organized as shareholder-controlled corporations and those organized as not-for-profit member-controlled corporations; (2) market-rate coops, limited-equity coops, and non-equity coops; (3) financing through “blanket mortgages” and financing through “share loans”; (4) coops that own their own buildings while leasing the land and coops that lease both the land and the buildings; and (5) manufactured housing park coops and other housing coops.

**Shareholder corporations vs. not-for-profit corporations.** Except in states that have adopted legislation providing specifically for housing coops, shareholder coops are incorporated under the same “business corporation laws” under which conventional businesses are incorporated. Such laws give a corporation the right to own, buy and sell property and do business as though it were in most respects an individual. The ultimate control of the corporation is held by the “shareholders” – the people who have purchased

shares of ownership. At the same time, the shareholders are protected in most respects from being held liable for actions taken by the corporation.

In most business corporations, the degree of ownership and control held by a single shareholder is based on the number of shares that he or she owns – if a shareholder owns more than half the shares, he or she can out-vote all of the other shareholders. Shareholder *coops*, however, are significantly different in this respect: their articles of incorporation and bylaws limit each shareholder to a single share of ownership and a single vote on all issues that come before the shareholders, so all of them have an equal degree of control. (In states with statutes that specifically provide for coops, the principle of “one-shareholder-one-vote” is legally required for all shareholder corporations created under such laws.)

Not-for-profit coops are typically created in situations where the affordability of membership for low and very low income people is an overriding concern. They are incorporated as membership organizations under state not-for-profit corporation laws. All members of the corporation must be residents of the housing (unless a CLT or other sponsoring organization retains membership as well). As members, residents have the same degree of control over their housing as shareholder-residents of shareholder coops, but they do not have the same kind of ownership interest that shareholders have. They normally pay a modest membership fee when they join the coop, and this fee is normally refundable when they leave the coop and may earn interest for them during their tenure as members, but it does not give them a share of equity in the corporation.

In deciding what legal structure should be employed in creating a coop, CLTs should work closely with an attorney who is familiar both with the state laws under which the organization might be incorporated and with any requirements regarding state approval of an offering of coop shares.

**Market-rate, limited-equity, and non-equity coops.** CLTs are normally *not* concerned with *market-rate* coops, whose shares can be sold for “whatever the market will bear” (in areas like New York City where such coops are relatively common, the market will in fact “bear” very high prices). There is no limit on the extent to which the market value of such shares is can appreciate over time. By contrast, the value of shares in a *limited-equity* coop can appreciate only to the extent permitted by resale provisions written into the coop’s bylaws and proprietary lease.

Limited-equity coops vary considerably in both the initial price for which shares are sold and the extent to which share prices are allowed to increase beyond the initial price when they are resold. For coops that are not deeply subsidized and that are not able to arrange debt financing for a high percentage of the cost of acquisition and development, the proceeds from the initial sale of shares will need to cover a significant portion of the coop’s total cost. (If such shares are to be made affordable for low income people, it will be necessary, as noted below, to arrange affordable financing for the purchasers on a share-by-share basis.)

For coops that are deeply subsidized and affordably financed, initial share prices can sometimes be as low as the membership fees charged to members of not-for-profit coops, and may appreciate as little as not-for-profit membership fees that accrue only modest interest. The term “*non-equity* coops” is usually used to describe not-for-profit coops, but might be applied also to coops that are technically organized as shareholder

corporations but that limit the shareholder's financial stake to the equivalent of a modest refundable membership fee.

**Blanket mortgages vs. share loans.** As the term is used regarding housing coops, *blanket mortgages* are real estate loans made to the coop corporation and secured with a mortgage lien on the corporation's property. One of the reasons that CLTs may consider using the coop model to provide affordable homeownership opportunities for low-income people (even when the homes are to be free-standing single-family units as in the case of the Lopez coops) is the fact that lenders may be more willing to make one large blanket loan to a corporation than a number of small loans to low-income individuals.

*Share loans* are loans made to individuals to finance the purchase of coop shares. They are not collateralized by real estate. For coops serving low-income memberships, the goal is normally to arrange blanket mortgage financing for as much as possible of the unsubsidized cost of acquiring and/or developing the housing, so that share prices will be low enough so that members can afford them or can finance their purchase with relatively small share loans. Conventional lenders are generally unwilling to make these uncollateralized loans to low income people on affordable terms, but it can be possible to develop access to such loans from other sources – including nonprofit loan funds and in some cases specialized funds capitalized and managed by CLTs or other coop sponsors, or by coops themselves. Alternatively, some coops have used individual development account (IDA) programs to help at least the initial members to accumulate the funds needed to buy shares.

It should be emphasized that when the value of coop shares, though limited, is still allowed to appreciate significantly, the need for share loans to finance the purchase of the potentially more expensive shares when they are resold becomes an increasingly difficult issue. Some early CLT-initiated coops were launched with share resale provisions that allowed substantial appreciation in share value, while their bylaws (and often their agreements with subsidy sources) permitted share resale only to low-income people. In most cases no arrangements had been made to make share loans available to new buyers. The result was that initial members were led to believe that they would be able to sell their shares for prices that, in reality, most eligible buyers would not be able to pay.

**Ownership vs. leasehold coops.** The usual assumption regarding CLT-initiated coops is that the coop will lease land from the CLT but will own the buildings and other improvements on the land. However, CLTs may also play a role in initiating *leasehold coops*, which lease both land and buildings – usually from a limited partnership that has been formed to develop and own the property so as to utilize tax credit financing. In such cases, the CLT may act as the “general partner” that manages the project, with “limited partners” (normally banks or other corporations) providing equity investments in return for federal affordable housing tax credits. These tax-credit-financed leasehold coops obviously have no equity in the property they occupy and are therefore normally incorporated as non-equity not-for-profit organizations. Like the more conventional tax-credit financed rental projects, they are normally large projects that require professional management. Of all types of coops, they are least likely to feel like a form of homeownership to the residents. Nonetheless, the members do have a substantial amount of control over the management of their housing – far more than conventional tenants have – if they choose to exercise it and receive adequate training and support. They may

also have the option to assume ownership of the housing when the tax credits eventually expire and the limited partnership is dissolved.

**Manufactured housing park coops.** Manufactured housing parks (aka mobile home parks) are real estate developments that provide “lot sites” – with access to roads, water, sewer and power lines – which are rented to people who own their own manufactured housing on these sites. Such parks provide a relatively affordable form of homeownership for a great many people, but they do not provide long-term security for owners of manufactured housing, who have only short-term leases to their lot sites (typically one-year or even month-to-month leases) *unless* the residents themselves organize a coop and gain control of the park. Such coops are becoming increasingly common. (In New Hampshire, as of this writing, nearly 100 parks have been converted to resident ownership in this way through a program of the New Hampshire Community Loan Fund, which has become the model for a national program known as ROC [Resident Owned Communities]-USA.)

Most of these coops acquire fee simple title to the land and then enter into very long-term leases with their members for the individual lot sites. It is also possible, however, for a CLT to acquire fee simple title to the land and then enter into a very long-term master ground lease for the whole park with a residents association or coop, which then subleases lot sites to individual residents. This arrangement is particularly appropriate when resident acquisition of the park is subsidized specifically to provide long-term affordability for lower income people. In such cases, the CLT’s master lease can establish requirements regarding sub-lessee income levels and sub-lease fees just as CLT ground leases to housing coops do. (Resale price restrictions may or may not be applied to the resale of the manufactured housing itself.)

### Questions for CLTs Considering Coop Projects

The planning of a coop and its relationship to a CLT is a complicated matter, and there are many questions to be considered. We will first review basic questions that a CLT should consider in connection with any potential coop project. We will then review additional questions that are important to consider in connection with projects involving the conversion of occupied rental property to coop ownership.

**Basic questions.** Questions that must be addressed for all CLT-sponsored coops include the following:

- *Constituency.* Should the intended constituency be defined entirely in terms of income levels? (If so, what income levels?) Or should the intended constituency also to be defined in other terms – e.g., students, people with disabilities, artisans requiring work-space, etc.? What advantages or opportunities would the coop model – as compared with other ownership models – offer the intended constituency? What kind of coop could best serve this constituency – limited equity shareholder coop, non-equity not-for profit coop, leasehold coop?
- *CLT’s role.* If a CLT is to be involved in a coop project, what will its role – or roles – be? Will it be the entity that creates the coop corporation? Will it acquire and develop the property for the coop before the coop begins operating? Will it market the coop shares (or memberships), and select initial residents? Will it be the long-term land-owner? If it is to be the land-owner (ground lessor), what lease restrictions

will the CLT be responsible for enforcing regarding the coop's operation and transfer of shares? Can the CLT be a long-term source of guidance and support for the coop? If not, are there other possible sources of guidance and support?

- *Marketability.* Does (or can) the relatively unfamiliar coop model have enough appeal in the local community to be marketable?
- *Size.* How large will the coop be? Given the nature of the particular clientele and other specific circumstances, can the coop be large enough to maintain stable operations as some members depart and others take their places? What can the CLT do to reinforce long-term stability?
- *Training.* Can adequate training be made available – both initially and as needed on an ongoing basis? Can the CLT provide it? If not, is there another possible source of training? How will training be paid for?
- *Member participation.* Can prospective members be involved in planning the coop corporation? Can they be involved in planning and/or carrying out construction?
- *Financing.* Can adequate subsidy and the necessary blanket mortgage financing be made available for this form of housing?
- *Share resale issues.* For a limited equity shareholder coop, to what extent can the value of shares be allowed to appreciate and still be affordable for potential future members in the targeted income range? Is there a way to make share loans available?
- *Management.* To what extent will self-management be feasible for the coop? To what extent will it be possible for the coop to contract for professional management services? How will training on management issues be provided? What will be the CLT's ongoing role regarding management?

**Questions re. coop conversions.** If a CLT is considering converting an occupied rental property to cooperative ownership, the following questions must also be addressed:

- *Current residents' understanding and interest.* Do the current residents of the rental property have a clear idea of what coop ownership would mean? Do they have a genuine interest in owning the property as a coop? Or are they more interested in the quality and cost of their housing than in issues of ownership and control?
- *Current residents' capacity to function as coop members.* To what extent do existing tenants know and interact with each other? Do they already feel that they have a shared interest in what happens to their housing? If a self-managed coop is envisioned, do the current residents have the ability (given appropriate training) to manage successfully?
- *Affordability for current residents.* If a limited equity shareholder coop is envisioned, how much can current residents afford to pay for shares? Can share loans be made available on an appropriate basis? Could a not-for-profit non-equity coop be made more affordable?
- *Future marketability.* Even if there is strong interest among existing tenants, will membership in this coop be desirable enough (because of the location and quality of the housing and/or the character of the membership) to support future marketing of units when current residents leave?
- *Provisions for current residents not interested in coop membership.* How many current residents are not interested in membership? Do they want to remain in the

building(s)? What arrangements could be made to allow them to remain as non-members? What arrangements could be made to help them relocate?

### **The CLT-Coop Ground Lease**

Most of the issues that a CLT-Coop ground lease must address are essentially the same as those addressed in the more common ground lease between a CLT and a single-family homeowner. Nonetheless, there are some distinctive differences. The most obvious overall difference is of course that the CLT-coop relationship entails an additional “layer.” Although the CLT’s ultimate concern with a housing coop is still to provide affordable, secure long-term housing tenure for lower income households, it is not entering into a lease with each of those households individually; it is entering into a lease with the coop corporation that they control. The lease establishes certain rights and obligations of the corporation with regard to the CLT. But it also defines the rights and obligations of the corporation’s *members* with regard to the CLT and the leased land. And finally it defines the coop’s obligations to enforce its members’ compliance with coop policies and the terms of the lease.

**Similarities with single-family model.** Much of the Model CLT-Coop Ground Lease presented below was derived from the model single-family CLT ground lease, the 2011 version of which is presented in Chapter 11-A. Since so many of the issues that must be addressed in the coop lease do not differ significantly from those addressed in the single-family model, most sections of the coop model borrow language directly from comparable sections of the single-family model, which has been shaped by thirty years of actual CLT experience and is already familiar to most CLTs.

Articles of the lease that have required only limited adaptation include the following (as numbered in the coop lease):

1. Leasing of Rights to Land
2. Term of Lease; Change of Land Owner
4. Lease Fee
5. Taxes and Assessments
6. The Improvements
7. Financing
8. Liability, Insurance, Damage and Destruction, Eminent Domain
11. Default
12. Mediation and Arbitration
13. General Provisions (except section 13.1, which differs significantly)

**Differences from single-family model.** The major differences between the Model CLT-Coop Ground Lease and the single-family model occur in Articles 3, 9, and 10 of the coop model.

Article 3, “Use of Leased Land,” although similar to the comparable article in the single-family lease in most respects, differs significantly in two ways: (1) the primary use is defined not only generally as “residential” but specifically as the operation of a limited equity housing cooperative; and (2) the language of most sections of this article has been modified so that it applies not only to use by the coop as a corporate entity but to use by the individual members as well.

“Article 9: Transfer of Improvements” has been modified in various ways, recognizing that the subject of the article is not the more or less predictable eventual sale (or inheritance) of a single-family home but the transfer of all the coop’s housing to another entity – a far less predictable kind of transaction, if it happens at all.

Article 10, “Coop’s Obligations and CLT’s Rights Regarding Operation Of the Coop,” brings together in one place a number of provisions relating to how the coop is to operate and how it is to deal with actions of its members on critical issues. Much of the detail involved in these matters is left to be presented in the attached exhibits containing the coop’s bylaws and proprietary lease and “income and affordability requirements” – all of which can be expected to vary significantly from one coop to another.

The initial article of the single-family lease, dealing with letters of agreement and attorney’s acknowledgement, has been omitted in the coop lease since such letters are normally unnecessary with a corporate lessee.

Section-by-section commentary on the Model CLT-Coop Lease is presented in Chapter 15-B

## MODEL CLT-COOP LEASE

*For section-by-section commentary on this model lease, see Chapter 15-B.*

THIS LEASE (“this Lease” or “the Lease”) entered into this \_\_\_\_\_ day of \_\_\_\_\_, 20\_\_\_\_, between \_\_\_\_\_ COMMUNITY LAND TRUST (“CLT”) and \_\_\_\_\_ (“Coop”).

### RECITALS

- A.** The CLT is organized exclusively for charitable purposes, including the purpose of providing secure resident-controlled housing for low and moderate income people.
- B.** The Leased Land described in this Lease has been acquired and is being leased by the CLT to the Coop in furtherance of this purpose.
- C.** The Coop has agreed to enter into this Lease not only to obtain the benefits of secure resident-controlled housing for its members, but also to further the charitable purposes of the CLT.
- D.** Coop and CLT recognize the special nature of the terms of this Lease, and each of them accepts these terms, including those terms that affect the marketing and resale price of the property by the Coop and the resale of Coop shares by the Coop’s members .
- E.** Coop and CLT agree that the terms of this Lease further their shared goals over an extended period of time.

**NOW THEREFORE**, Coop and CLT agree on the terms and conditions of this Lease as set forth below.

**DEFINITIONS:** Coop and CLT agree on the following definitions of key terms used in this Lease.

*Leased Land:* the parcel of land described in Exhibit: LEASED LAND, which the CLT is leasing to the Coop.

*Improvements:* the residential structure and other permanent improvements located on the Leased Land, including both the original Improvements described in Exhibit: DEED and all permanent improvements added thereafter by Coop at Coop's expense.

*Limited equity housing cooperative:* a corporation formed for the purpose of providing resident-controlled housing with long-term security of tenure for low and moderate income people. It is controlled by shareholders who live in buildings owned by the corporation. The shareholders' rights are limited by the terms of the corporation's bylaws. The Coop that is a party to this Lease is a limited equity housing cooperative.

*Members:* the people who own shares in the Coop and hold proprietary leases to residential units in the Coop-owned Improvements.

*Lease Fee:* The monthly fee that the Coop pays to the CLT for continuing use of the Leased Land and any additional amounts that the CLT charges the Coop for reasons permitted by this Lease.

*Permitted Mortgage:* A mortgage or deed of trust on the Improvements and the Coop's interest in the Leased Land granted to a lender by the Coop with the CLT's Permission. The Coop may not mortgage the CLT's interest in the Leased Land, and may not grant any mortgage or deed of trust without CLT's Permission.

*Event of Default:* Any violation of the terms of the Lease that has not been corrected ("cured") by Coop or the holder of a Permitted Mortgage in the specified period of time after a written Notice of Default has been given by CLT.

#### **ARTICLE 1: Leasing of Rights to the Land**

1.1 CLT LEASES THE LAND TO COOP: The CLT hereby leases to the Coop, and Coop hereby accepts, the right to possess, occupy and use the Leased Land (described in the attached Exhibit LEASED LAND) in accordance with the terms of this Lease. CLT has furnished to Coop a copy of the most current title report, if any, obtained by CLT for the Leased Land, and Coop accepts title to the Leased Land in its condition "as is" as of the signing of this Lease.

1.2 MINERAL RIGHTS NOT LEASED TO COOP: CLT does not lease to Coop the right to remove from the Leased Land any minerals lying beneath the Leased Land's surface. Ownership of such minerals remains with the CLT, but the CLT shall not remove any such minerals from the Leased Land without the Coop's written permission.

#### **ARTICLE 2: Term of Lease, Change of Land Owner**

2.1 TERM OF LEASE IS 99 YEARS: This Lease shall remain in effect for 99 years, beginning on the \_\_\_ day of \_\_\_\_\_, 20\_\_\_, and ending on the \_\_\_\_\_ day of \_\_\_\_\_, 20\_\_\_\_, unless ended sooner or renewed as provided below.

2.2 COOP CAN RENEW LEASE FOR ANOTHER 99 YEARS: Coop may renew this Lease for one additional period of 99 years. The CLT may change the terms of the Lease for the renewal period prior to the beginning of the renewal period but only if these changes do not materially and adversely interfere with the rights possessed by Coop under the Lease. Not more than 365 or less than 180 days before the last day of the first 99-year period, CLT shall give Coop a written notice that states the date of the expiration of the first 99-year period and the conditions for renewal as set forth in the following

paragraph (“the Expiration Notice”). The Expiration Notice shall also describe any changes that CLT intends to make in the Lease for the renewal period as permitted above.

The Coop shall then have the right to renew the Lease only if the following conditions are met: (a) within 60 days of receipt of the Expiration Notice, the Coop shall give CLT written notice stating the Coop’s desire to renew (“the Renewal Notice”); (b) this Lease shall be in effect on the last day of the original 99-year term, and (c) the Coop shall not be in default under this Lease or under any Permitted Mortgage on the last day of the original 99-year term.

When Coop has exercised the option to renew, Coop and CLT shall sign a memorandum stating that the option has been exercised. The memorandum shall comply with the requirements for a notice of lease as stated in Section 13.12 below. The CLT shall record this memorandum in accordance with the requirements of law promptly after the beginning of the renewal period.

**2.3 WHAT HAPPENS IF CLT DECIDES TO SELL THE LEASED LAND:** If ownership of the Leased Land is ever transferred by CLT (whether voluntarily or involuntarily) to any other person or institution, this Lease shall not cease, but shall remain binding on the new land-owner as well as the Coop. If CLT agrees to transfer the Leased Land to any person or institution other than a non-profit corporation, charitable trust, government agency or other similar institution sharing the goals described in the Recitals above, the Coop shall have a right of first refusal to purchase the Leased Land. The details of this right shall be as stated in the attached Exhibit FIRST REFUSAL. Any sale or other transfer contrary to this Section 3.3 shall be null and void.

### **ARTICLE 3: Use of Leased Land**

**3.1 LEASED LAND MUST BE USED FOR THE OPERATION OF A LIMITED EQUITY HOUSING COOPERATIVE:** The leased land must be used for the operation of a limited equity housing cooperative in full compliance with the terms of this lease.

**3.2 COOP AND ITS MEMBERS MAY USE THE IMPROVEMENTS ONLY FOR RESIDENTIAL AND RELATED PURPOSES:** Coop shall use, and allow its Members to use, the Improvements and Leased Land only for residential purposes and any activities related to residential use that were permitted by local zoning law when the Lease was signed, as indicated in the attached Exhibit ZONING. **[To be added when needed: Use of the Leased Land shall be further limited by the restrictions described in the attached Exhibit RESTRICTIONS.]**

**3.3 COOP AND ITS MEMBERS MUST USE THE IMPROVEMENTS AND LEASED LAND RESPONSIBLY AND IN COMPLIANCE WITH THE LAW:** The Coop and its Members shall use the Improvements and Leased Land only in ways that will not cause harm to others or create any public nuisance. Coop and its Members shall dispose of all waste in a safe and sanitary manner. Coop and its Members shall maintain all parts of the Improvements and Leased Land in safe, sound and habitable condition, in full compliance with all laws and regulations, and in the condition that is required to maintain the insurance coverage required by Section 8.4 of this Lease.

**3.4 COOP IS RESPONSIBLE FOR USE BY OTHERS:** The Coop shall be responsible for the use of the Improvements and Leased Land by all Members and visitors and

anyone else using the Leased Land with the permission of the Coop or its Members, and shall make all such people aware of the restrictions on use set forth in this Lease.

3.5 LEASED LAND MAY NOT BE SUBLEASED TO NON-MEMBERS WITHOUT CLT'S PERMISSION. Except as subleases to Members are permitted in Article 10 and except as otherwise provided in Article 7 and Article 9, Coop shall not sublease, sell or otherwise convey any of Coop's rights under this Lease, for any period of time, without the written permission of CLT. Coop agrees that CLT shall have the right to withhold such consent in order to further the purposes of this Lease.

3.6 CLT HAS A RIGHT TO INSPECT THE LEASED LAND: The CLT may inspect any part of the Leased Land except the interiors of fully enclosed buildings, at any reasonable time, after notifying the Coop at least 24 hours before the planned inspection. No more than \_\_\_ regular inspections may be carried out in a single year, except in the case of an emergency. In an emergency, the CLT may inspect any part of the Leased Land except the interiors of fully enclosed buildings, after making reasonable efforts to inform the Coop before the inspection.

If the CLT has received an Intent-To-Sell Notice (as described in Section 9.3 below), then the CLT has the right to inspect the interiors of all fully enclosed buildings to determine their condition prior to the sale. The CLT must notify the Homeowner at least 24 hours before carrying out such inspection.

3.7 COOP AND ITS MEMBERS HAVE A RIGHT TO QUIET ENJOYMENT: The Coop and its Members have the right to quiet enjoyment of the Leased Land. The CLT has no desire or intention to interfere with the personal lives, associations, expressions, or actions of the Members in any way not permitted by this Lease.

#### **ARTICLE 4: Lease Fee**

4.1 AMOUNT OF LEASE FEE: The Coop shall pay a monthly Lease Fee in the amount of \$ \_\_\_ in return for the continuing right to possess, occupy and use the Leased Land.

4.2 WHEN THE LEASE FEE IS TO BE PAID: The Lease Fee shall be payable to CLT on the first day of each month for as long as this Lease remains in effect, unless the Lease Fee is to be escrowed and paid by a Permitted Mortgagee, in which case payment shall be made as directed by that Mortgagee.

4.3 HOW THE AMOUNT OF THE LEASE FEE HAS BEEN DETERMINED: The amount of the Lease Fee stated in Section 4.1 above has been determined as follows. First, the approximate monthly fair rental value of the Leased Land has been established, as of the beginning of the Lease term, recognizing that the fair rental value is reduced by certain restrictions imposed by the Lease on the use of the Land. Then the affordability of this monthly amount for the Coop, as a limited equity housing cooperative serving low and moderate income Members, has been analyzed and, if necessary, the Lease Fee has been reduced to an amount considered to be affordable for the Coop.

4.4 CLT MAY REDUCE OR SUSPEND THE LEASE FEE TO IMPROVE AFFORDABILITY: CLT may reduce or suspend the total amount of the Lease Fee for a period of time for the purpose of improving the affordability of the Coop's use of the Leased Land. Any such reduction or suspension must be in writing and signed by CLT.

4.5 FEES MAY BE INCREASED FROM TIME TO TIME: The CLT may increase the amount of the Lease Fee from time to time, but not more often than once every \_\_\_ years. Each time such amounts are increased, the total percentage of increase since the date this Lease was signed shall not be greater than the percentage of increase, over the same period of time, in the Consumer Price Index for urban wage earners and clerical workers for the urban area in which the Leased Land is located, or, if none, for urban areas the size of \_\_\_\_\_.

4.6 LEASE FEE WILL BE INCREASED IF RESTRICTIONS ARE REMOVED: If, for any reason, the provisions of Article 9 regarding transfers of the Improvements or Section 3.1 and Article 10 regarding use of the Leased Land for operation of a limited equity housing cooperative are suspended or invalidated for any period of time, then during that time the Lease Fee shall be increased to an amount calculated by CLT to equal the fair rental value of the Leased Land for use not restricted by the suspended provisions, but initially an amount not exceeding \_\_\_ dollars. Such increase shall become effective upon CLT's written notice to the party then in the role of ground lessee. Thereafter, for so long as these restrictions are not reinstated in the Lease, the CLT may, from time to time, further increase the amount of such Lease Fee, provided that the amount of the Fee does not exceed the fair rental value of the property, and provided that such increases do not occur more often than once in every \_\_\_ years.

4.7 IF PAYMENT IS LATE, INTEREST CAN BE CHARGED: If the CLT has not received any monthly installment of the Lease Fee on or before the date on which such installment first becomes payable under this Lease (the "Due Date"), the CLT may require Coop to pay interest on the unpaid amount from the Due Date through and including the date such payment or installment is received by CLT, at a rate not to exceed \_\_\_\_\_. *[Specify either a fixed %, an index such as prime rate of a particular institution, or a legally established limit].* Such interest shall be deemed additional Lease Fee and shall be paid by Coop to CLT upon demand; provided, however, that CLT shall waive any such interest that would otherwise be payable to CLT if such payment of the Lease Fee is received by CLT on or before the thirtieth (30<sup>th</sup>) day after the Due Date.

4.8 CLT CAN COLLECT UNPAID FEES WHEN IMPROVEMENTS ARE SOLD: In the event that any amount of payable Lease Fee remains unpaid when the Improvements are sold, the outstanding amount of payable Lease Fee, including any interest as provided above, shall be paid to CLT out of any proceeds from the sale that would otherwise be due to Coop. The CLT shall have, and the Coop hereby consents to, a lien upon the Improvements for any unpaid Lease Fee. Such lien shall be prior to all other liens and encumbrances on the Improvements except (a) liens and encumbrances recorded before the recording of this Lease, (b) Permitted Mortgages as defined in section 7.1 below; and (c) liens for real property taxes and other governmental assessments or charges against the Improvements.

#### **ARTICLE 5: Taxes and Assessments**

5.1 COOP IS RESPONSIBLE FOR PAYING ALL TAXES AND ASSESSMENTS: Coop shall pay directly, when due, all taxes and governmental assessments that relate to the Improvements and the Leased Land (including any taxes relating to the CLT's interest in the Leased Land).

**5.2 CLT WILL PASS ON ANY TAX BILLS IT RECEIVES TO COOP:** In the event that the local taxing authority bills CLT for any portion of the taxes on the Improvements or Leased Land, CLT shall pass the bill to Coop and Coop shall promptly pay this bill.

**5.3 COOP HAS A RIGHT TO CONTEST TAXES:** Coop shall have the right to contest the amount or validity of any taxes relating to the Improvements and Leased Land. Upon receiving a reasonable request from Coop for assistance in this matter, CLT shall join in contesting such taxes. All costs of such proceedings shall be paid by Coop.

**5.4 IF COOP FAILS TO PAY TAXES, CLT MAY INCREASE LEASE FEE:** In the event that Coop fails to pay the taxes or other charges described in Section 6.1 above, CLT may increase Coop's Lease Fee to offset the amount of taxes and other charges owed by Coop. Upon collecting any such amount, CLT shall pay the amount collected to the taxing authority in a timely manner.

**5.5 PARTY THAT PAYS TAXES MUST SHOW PROOF:** When either party pays taxes relating to the Improvements or Leased Land, that party shall furnish satisfactory evidence of the payment to the other party. A photocopy of a receipt shall be the usual method of furnishing such evidence.

#### **ARTICLE 6: The Improvements**

**6.1 COOP OWNS THE BUILDINGS AND ALL OTHER IMPROVEMENTS ON THE LEASED LAND:** All structures, including buildings, fixtures, and other improvements purchased, constructed, or installed by the Coop on any part of the Leased Land at any time during the term of this Lease (collectively, the "Improvements") shall be property of the Coop. Title to the Improvements shall be and remain vested in the Coop. However, Coop's rights of ownership are limited by certain provisions of this Lease, including those regarding the sale or leasing of the Improvements by the Coop and the CLT's option to purchase the Improvements. In addition, Coop shall not remove any part of the Improvements from the Leased Land without CLT's prior written consent.

**6.2 COOP PURCHASES IMPROVEMENTS WHEN SIGNING LEASE:** Upon the signing of this Lease, Coop is simultaneously purchasing the Improvements located at that time on the Leased Land, as described in the Deed, a copy of which is attached to this Lease as Exhibit: DEED.

**6.3 CONSTRUCTION CARRIED OUT BY COOP MUST COMPLY WITH CERTAIN REQUIREMENTS:** Any construction in connection with the Improvements is permitted only if the following requirements are met: (a) all costs shall be paid for by the Coop; (b) all construction shall be performed in a professional manner and shall comply with all applicable laws and regulations; (c) all changes in the Improvements shall be consistent with the permitted uses described in Article 3; (d) the footprint, square-footage, or height of existing buildings shall not be increased and new structures shall not be built or installed on the Leased Land without the prior written consent of CLT.

For any construction requiring CLT's prior written consent, Coop shall submit a written request to the CLT. Such request shall include:

- a) a written statement of the reasons for undertaking the construction;
- b) a set of drawings (floor plan and elevations) showing the dimensions of the proposed construction.

If the CLT finds it needs additional information it shall request such information from Coop within two weeks of receipt of Coop's request. The CLT then, within two weeks of receiving all necessary information (including any additional information it may have requested) shall give Coop either its written consent or a written statement of its reasons for not consenting. Before construction can begin, Coop shall provide CLT with copies of all necessary building permits not previously provided.

**6.4 COOP MAY NOT ALLOW STATUTORY LIENS TO REMAIN AGAINST LEASED LAND OR IMPROVEMENTS:** No lien of any type shall attach to the CLT's title to the Leased Land. Coop shall not permit any statutory or similar lien to be filed against the Leased Land or the Improvements which remains more than 60 days after it has been filed. Coop shall take action to discharge such lien, whether by means of payment, deposit, bond, court order, or other means permitted by law. If Coop fails to discharge such lien within the 60-day period, then Coop shall immediately notify CLT of such failure. CLT shall have the right to discharge the lien by paying the amount in question. Coop may, at Coop's expense, contest the validity of any such asserted lien, provided Coop has furnished a bond or other acceptable surety in an amount sufficient to release the Leased Land from such lien. Any amounts paid by CLT to discharge such liens shall be treated as an additional Lease Fee payable by Coop upon demand.

**6.5 COOP IS RESPONSIBLE FOR SERVICES, MAINTENANCE AND REPAIRS:** Coop hereby assumes responsibility for furnishing all services or facilities on the Leased Land, including but not limited to heat, electricity, air conditioning and water. CLT shall not be required to furnish any services or facilities or to make any repairs to the Improvements. Coop shall maintain the Improvements and Leased Land as required by Section 3.3 above and shall see that all necessary repairs and replacements are accomplished when needed.

**6.6 IMPROVEMENTS SHALL NOT BE REMOVED. WHEN LEASE ENDS, OWNERSHIP OF IMPROVEMENTS REVERTS TO CLT:** The Improvements owned by the Coop shall not be removed from the Leased Land. Upon the expiration or termination of this Lease, ownership of the Improvements shall revert to CLT. Upon thus assuming title to the Improvements, CLT shall promptly pay Coop and Permitted Mortgagee(s), as follows:

FIRST, CLT shall pay any Permitted Mortgagee(s) the full amount owed to such mortgagee(s) by Coop;

SECOND, CLT shall pay the Coop the balance of the Purchase Option Price calculated in accordance with Article 10 below, as of the time of reversion of ownership, less the total amount of any unpaid Lease Fee and any other amounts owed to the CLT under the terms of this Lease. The Coop shall be responsible for any costs necessary to clear any additional liens or other charges related to the Improvements which may be assessed against the Improvements. If the Coop fails to clear such liens or charges, the balance due the Coop shall also be reduced by the amount necessary to release such liens or charges, including reasonable attorneys' fees incurred by the CLT.

## **ARTICLE 7: Financing**

**7.1 COOP CANNOT MORTGAGE THE IMPROVEMENTS WITHOUT CLT'S PERMISSION:** The Coop may mortgage the Improvements and the leasehold interest in

the land only with the written permission of CLT. Any mortgage or deed of trust permitted in writing by the CLT is defined as a Permitted Mortgage, and the holder of such a mortgage or deed of trust is defined as a Permitted Mortgagee.

**7.2 BY SIGNING LEASE, CLT GIVES PERMISSION FOR ORIGINAL MORTGAGE.** By signing this Lease, CLT gives written permission for any mortgage or deed of trust signed that day by the Coop for the purpose of financing Coop's purchase of the Improvements.

**7.3 CLT PERMISSION IS REQUIRED FOR REFINANCING OR OTHER SUBSEQUENT MORTGAGES.** If, at any time subsequent to the purchase of the Improvements and signing of the Lease, the Coop seeks a loan that is to be secured by a mortgage on the Improvements and leasehold interest (to refinance an existing Permitted Mortgage or to finance Improvements repairs or for any other purpose), Coop must inform CLT, in writing, of the proposed terms and conditions of such mortgage loan at least 15 business days prior to the expected closing of the loan. Upon being thus informed in writing, CLT may request additional information before granting or denying permission.

**7.4 A PERMITTED MORTGAGEE HAS CERTAIN OBLIGATIONS UNDER THE LEASE.** Any Permitted Mortgagee shall be bound by each of the requirements stated in "Exhibit: Permitted Mortgages, Part A, Obligations of Permitted Mortgagee," which is made a part of this Lease by reference, unless the particular requirement is removed, contradicted or modified by a Rider to this Lease signed by the Coop and the CLT to modify the terms of the Lease during the term of the Permitted Mortgage.

**7.5 A PERMITTED MORTGAGEE HAS CERTAIN RIGHTS UNDER THE LEASE.** Any Permitted Mortgagee shall have all of the rights and protections stated in "Exhibit: Permitted Mortgages, Part B, Rights of Permitted Mortgagee," which is made a part of this Lease by reference.

**7.6 IN THE EVENT OF FORECLOSURE, ANY PROCEEDS IN EXCESS OF THE PURCHASE OPTION PRICE WILL GO TO CLT.** Coop and CLT recognize that it would be contrary to the purposes of this agreement if Coop could receive more than the Purchase Option Price as the result of the foreclosure of a mortgage. Therefore, Coop hereby irrevocably assigns to CLT all net proceeds of sale of the Improvements that would otherwise have been payable to Coop and that exceed the amount of net proceeds that Coop would have received if the property had been sold for the Purchase Option Price, calculated as described in Section 9.10 below. Coop authorizes and instructs the Permitted Mortgagee, or any party conducting any sale, to pay such excess amount directly to CLT. If, for any reason, such excess amount is paid to Coop, Coop hereby agrees to promptly pay such amount to CLT.

#### **ARTICLE 8: Liability, Insurance, Damage and Destruction, Eminent Domain**

**8.1 COOP ASSUMES ALL LIABILITY.** Coop assumes all responsibility and liability related to Coop's possession, occupancy and use of the Leased Land.

**8.2 COOP MUST DEFEND CLT AGAINST ALL CLAIMS OF LIABILITY.** Coop shall defend, indemnify and hold CLT harmless against all liability and claims of liability for injury or damage to person or property from any cause on or about the Leased Land. Coop waives all claims against CLT for injury or damage on or about the Leased Land.

However, CLT shall remain liable for injury or damage due to any grossly negligent or intentional acts or omissions of CLT or CLT's agents or employees.

8.3 COOP MUST REIMBURSE CLT. In the event the CLT shall be required to pay any sum that is the Coop's responsibility or liability, the Coop shall reimburse the CLT for such payment and for reasonable expenses caused thereby.

8.4 COOP MUST INSURE THE IMPROVEMENTS AGAINST LOSS AND MUST MAINTAIN LIABILITY INSURANCE ON IMPROVEMENTS AND LEASED LAND. Coop shall, at Coop's expense, keep the Improvements continuously insured against "all risks" of physical loss for the full replacement value of the Improvements, and in any event in an amount that will not incur a coinsurance penalty. The amount of such insured replacement value must be approved by the CLT prior to the commencement of the Lease. Thereafter, if the CLT determines that the replacement value to be insured should be increased, the CLT shall inform the Coop of such required increase at least 30 days prior to the next date on which the insurance policy is to be renewed, and the Coop shall assure CLT that the renewal includes such change. If Coop wishes to decrease the amount of replacement value to be insured, Coop shall inform the CLT of the proposed change at least 30 days prior to the time such change would take effect. The change shall not take effect without CLT's approval.

Should the Improvements lie in a flood hazard zone as defined by the National Flood Insurance Plan, the Coop shall keep in full force and effect flood insurance in the maximum amount available.

The Coop shall also, at its sole expense, maintain in full force and effect public liability insurance in the amount of \$\_\_\_\_\_ per occurrence and in the aggregate. The CLT shall be named as an additional insured, and certificates of insurance shall be delivered to the CLT prior to the commencement of the Lease and at each anniversary date thereof.

The dollar amounts of such coverage may be increased from time to time at the CLT's request but not more often than once in any one-year period. CLT shall inform the Coop of such required increase in coverage at least 30 days prior to the next date on which the insurance policy is to be renewed, and the Coop shall assure CLT that the renewal includes such change. The amount of such increase in coverage shall be based on current trends in liability insurance coverage in the area in which the Improvements is located.

8.5 WHAT HAPPENS IF IMPROVEMENTS ARE DAMAGED OR DESTROYED. Except as provided below, in the event of fire or other damage to the Improvements, Coop shall take all steps necessary to assure the repair of such damage and the restoration of the Improvements to their condition immediately prior to the damage. All such repairs and restoration shall be completed as promptly as possible. Coop shall also promptly take all steps necessary to assure CLT that the Leased Land is safe and that the damaged Improvements do not constitute a danger to persons or property.

If Coop, based on professional estimates, determines either (a) that full repair and restoration is physically impossible, or (b) that the available insurance proceeds will pay for less than the full cost of necessary repairs and that Coop cannot otherwise afford to cover the balance of the cost of repairs, then Coop shall notify CLT of this problem, and CLT may then help to resolve the problem. Methods used to resolve the problem may

include efforts to increase the available insurance proceeds, efforts to reduce the cost of necessary repairs, efforts to arrange affordable financing covering the costs of repair not covered by insurance proceeds, and any other methods agreed upon by both Coop and CLT.

If Coop and CLT cannot agree on a way of restoring the Improvements in the absence of adequate insurance proceeds, then Coop may give CLT written notice of intent to terminate the Lease. The date of actual termination shall be no less than 60 days after the date of Coop's notice of intent to terminate. Upon termination, any insurance proceeds payable to Coop for damage to the Improvements shall be paid as follows.

FIRST, to the expenses of their collection;

SECOND, to any Permitted Mortgagee(s), to the extent required by the Permitted Mortgage(s);

THIRD, to the expenses of enclosing or razing the remains of the Improvements and clearing debris;

FOURTH, to the CLT for any amounts owed under this Lease;

FIFTH, to the Coop, up to an amount equal to the Purchase Option Price, as of the day prior to the loss, less any amounts paid with respect to the second, third, and fourth clauses above;

SIXTH, the balance, if any, to the CLT.

**8.6 WHAT HAPPENS IF SOME OR ALL OF THE LAND IS TAKEN FOR PUBLIC USE.** If all of the Leased Land is taken by eminent domain or otherwise for public purposes, or if so much of the Leased Land is taken that the Improvements are lost or damaged beyond repair, the Lease shall terminate as of the date when Coop is required to give up possession of the Leased Land. Upon such termination, the entire amount of any award(s) paid shall be allocated in the way described in Section 8.5 above for insurance proceeds.

In the event of a taking of a portion of the Leased Land that does not result in damage to the Improvements or significant reduction in the usefulness or desirability of the Leased Land for the Coop's residential purposes, then any monetary compensation for such taking shall be allocated entirely to CLT.

In the event of a taking of a portion of the Leased Land that results in damage to the Improvements only to such an extent that the Improvements can reasonably be restored to a residential use consistent with this Lease, then the damage shall be treated as damage is treated in Section 8.5 above, and monetary compensation shall be allocated as insurance proceeds are to be allocated under Section 8.5.

**8.7 IF PART OF THE LAND IS TAKEN, THE LEASE FEE MAY BE REDUCED.** In the event of any taking that reduces the size of the Leased Land but does not result in the termination of the Lease, CLT shall reassess the fair rental value of the remaining Land and shall adjust the Lease Fee if necessary to assure that the monthly fee does not exceed the monthly fair rental value of the Land for use as restricted by the Lease.

## **ARTICLE 9: Transfer of the Improvements**

**9.1 INTENT OF THIS ARTICLE IS TO PRESERVE USE BY LIMITED EQUITY COOPERATIVE:** Coop and CLT agree that the provisions of this Article 9 are intended to preserve the use of the Leased Land and Improvements for the operation of a limited

equity housing cooperative owned by and serving low and moderate income people, or, if use by such a cooperative is not possible, then use by such other entity as will provide appropriate housing for low and moderate income people.

**9.2 COOP MAY TRANSFER IMPROVEMENTS ONLY TO CLT OR AN APPROVED PURCHASER:** Coop may transfer the Improvements, for not more than the Purchase Option Price, only to the CLT or to another purchaser approved by the CLT.

**9.3 COOP SHALL GIVE NOTICE OF INTENT TO SELL:** In the event that the Coop wishes to sell the Improvements to another entity, the Coop shall notify CLT in writing of such wish (the Intent-to-Sell Notice). When submitting the Intent-to-Sell Notice, or at a subsequent time, the Coop may propose a potential purchaser to the CLT.

**9.4 AFTER RECEIVING NOTICE, CLT MAY COMMISSION AN APPRAISAL:** After CLT's receipt of Coop's Intent-to-Sell Notice, CLT may, at its discretion, commission a market valuation of the Improvements for purposes of determining the Purchase Option Price.

Such appraisal shall be performed by a duly licensed appraiser who is acceptable to both the CLT and the Coop. CLT shall pay the cost of the appraisal. The appraisal shall be conducted by analysis and comparison of comparable properties as though title to the Leased Land and Improvements were held in fee simple absolute by a single party, disregarding all of the restrictions of this Lease on the use, occupancy and transfer of the property. The appraisal shall state the value contributed by the Improvements as being the unrestricted value of the entire property (Leased Land and Improvements) minus the unrestricted value of the Leased Land. Copies of the Appraisal are to be provided to both CLT and Homeowner.

**9.5 CLT SHALL REVIEW AND APPROVE OR REJECT PROPOSED PURCHASER:** If Coop has proposed a potential purchaser, the CLT shall contact the potential purchaser and request from such entity the information necessary to determine whether purchase of the Improvements by such entity will be consistent with the intended use of the Leased Land as stated in Section 9.1 above. Without undue delay, CLT shall move to determine whether the proposed sale to such entity is consistent with such intended use. In its review of the proposed sale, the CLT shall invite all individual Members of the Coop to express their views on the matter. Upon completing its review CLT shall notify the Coop in writing of its decision to approve or reject the potential purchaser. If approved by the CLT, the proposed purchaser may purchase the Improvements for a price no greater than the Purchase Option Price as defined in Section 9.7 below.

**9.6 CLT HAS AN OPTION TO PURCHASE THE IMPROVEMENTS.** Upon receipt of an Intent-to-Sell Notice from Coop, and until such time as the Improvements have been sold to another entity, CLT shall have the option to purchase the Improvements at the Purchase Option Price calculated as set forth below. If CLT elects to purchase the Improvements, CLT shall exercise the Purchase Option by notifying Coop, in writing, of such election (the Notice of Exercise of Option). Having given such notice, CLT may either proceed to purchase the Improvements directly or may assign the Purchase Option to an approved purchaser.

The purchase (by CLT or CLT's assignee) must be completed within sixty (60) days of CLT's Notice of Exercise of Option, or within such longer period of time as CLT and Coop agree is necessary to complete the transaction.

9.7 HOW THE PURCHASE OPTION PRICE IS DETERMINED: In no event may the Improvements be sold for a price that exceeds the Purchase Option Price. The Purchase Option Price shall be the lesser of (a) the price calculated in accordance with the formula described in Section 9.8 below (the Formula Price) or, if an appraisal has been commissioned in accordance with Section 9.4 above, the as-if-unrestricted market value of the Improvements as determined by such appraisal.

9.8 HOW THE FORMULA PRICE IS DETERMINED: The Formula Price shall be equal to Coop's original Purchase Price, as stated below plus an amount reflecting the value of subsequent capital improvements paid for by the Coop provided that such improvements have been approved in writing by the CLT prior to construction and that such written approval has included guidelines for determining the monetary value that will be added by such improvements to the Formula Price. If such guidelines provide for the value of the capital improvements to be depreciated over time, the written approval shall specify the rate at which the value is to be depreciated.

The parties agree that the Lessee's Purchase Price for the Improvements existing on the Premises as of the commencement of the term of this Ground Lease is \$\_\_\_\_\_.

9.9 APPROVED PURCHASER SHALL RECEIVE NEW LEASE: The CLT shall issue a new lease to any entity that purchases the Improvements in accordance with the terms of this Article 9. If the approved purchaser's intended use is that of operating a limited equity housing cooperative owned by low and moderate income people, the terms of the new lease shall not differ substantially from the terms of this Lease. If a proposed purchaser's intended use is not that of operating a limited equity housing cooperative owned by and serving low and moderate income people, the CLT may negotiate new terms with the approved purchaser. Final approval of any proposed purchaser shall depend upon the proposed purchaser and the CLT reaching agreement on the terms of the new lease.

## **ARTICLE 10: Coop's Obligations and CLT's Rights Regarding Operation Of the Coop**

10.1 CLT MUST APPROVE AMENDMENTS TO COOP'S BYLAWS AND PROPRIETARY LEASE. In signing this Lease CLT thereby approves Coop's Bylaws (as attached in Exhibit COOP'S BYLAWS) and the terms of the Coop's Proprietary Lease (as attached in Exhibit PROPRIETARY LEASE). Any subsequent amendments to these documents must be approved in writing by CLT before becoming effective.

10.2 COOP MUST COMPLY WITH ATTACHED INCOME AND AFFORDABILITY REQUIREMENTS. In selling shares and entering into proprietary leases for residential units, the Coop shall comply fully with the terms of the attached Exhibit: INCOME AND AFFORDABILITY REQUIREMENTS.

10.3 COOP MUST COMPLY WITH ALL APPLICABLE LAWS AND REGULATIONS. Coop shall comply with all fair housing laws and all other laws and

regulations applicable to its operation as a limited-equity housing cooperative providing affordable housing for low and moderate income people.

**10.4 FAILURE TO COMPLY WITH APPLICABLE REQUIREMENTS**

**CONSTITUTES LEASE DEFAULT.** Any failure by Coop to comply with the terms and conditions of its Bylaws or Proprietary Leases or Income and Affordability Requirements or applicable laws and regulations, as well as any failure to enforce Member compliance with those requirements in this Lease that apply to Members, shall constitute a default under this Lease.

**10.5 IF COOP FAILS TO ENFORCE MEMBER COMPLIANCE, CLT MAY ACT TO ENFORCE.** In the event Coop fails to enforce member compliance with terms and conditions of the Bylaws or Proprietary Lease or applicable laws and regulations or this Lease, CLT may, but is not obligated to, take action, upon at least \_\_ days prior notice, to enforce such terms and conditions directly.

**10.6 COOP MUST NOTIFY CLT OF TRANSFERS OF SHARES.** Coop must give CLT written notice of any proposed transfers of Coop shares. Notice must include the price and other terms of sale and evidence of the transferee's income-eligibility.

**10.7 SUBLEASES OTHER THAN TO MEMBERS MUST BE APPROVED BY CLT.** Any subleasing of any portion of the Leased Land or Improvements to any party other than a Member of the Coop must be approved in writing by CLT.

**10.8 COOP MUST SUBMIT BUDGETS TO CLT.** For each fiscal year, Coop must submit a proposed budget to CLT prior to the beginning of such year. Such budget must include funding of an operating reserve and a replacement reserve in amounts approved by CLT.

**10.9 COOP MUST SUBMIT FINANCIAL REPORTS.** At three-month intervals, Coop must provide CLT with financial reports for its operation, including a balance sheet and a comparison of actual revenue and expense with budgeted revenue and expense for the year to date. The dates when these reports are to be submitted shall be as agreed by the parties from time to time.

**10.10 COOP MUST SUBMIT MINUTES.** Coop must submit copies of minutes of all Membership and Board meetings to CLT within thirty days of such meetings.

**10.11 COOP MUST SUBMIT MANAGEMENT CONTRACTS.** Coop must submit to CLT any proposed contracts for property management. Such contracts shall not become binding unless approved in writing by CLT.

**ARTICLE 11: DEFAULT**

**11.1 WHAT HAPPENS IF COOP FAILS TO MAKE PAYMENTS TO THE CLT THAT ARE REQUIRED BY THE LEASE:** It shall be an event of default if Coop fails to pay the Lease Fee or other charges required by the terms of this Lease and such failure is not cured by Coop or a Permitted Mortgagee within thirty (30) days after notice of such failure is given by CLT to Coop and Permitted Mortgagee. However, if Coop makes a good faith partial payment of at least two-thirds (2/3) of the amount owed during the 30-day cure period, then the cure period shall be extended by an additional 30 days.

**11.2 WHAT HAPPENS IF COOP VIOLATES OTHER (NONMONETARY) TERMS OF THE LEASE:** It shall be an event of default if Coop fails to abide by any other requirement or restriction stated in this Lease, and such failure is not cured by Coop or a Permitted Mortgagee within sixty (60) days after notice of such failure is given by CLT to Coop and Permitted Mortgagee. However, if Coop or Permitted Mortgagee has begun to cure such default within the 60-day cure period and is continuing such cure with due diligence but cannot complete the cure within the 60-day cure period, the cure period shall be extended for as much additional time as may be reasonably required to complete the cure.

**11.3 WHAT HAPPENS IF COOP DEFAULTS AS A RESULT OF JUDICIAL PROCESS:** It shall be an event of default if the estate hereby created is taken on execution or by other process of law, or if Coop is judicially declared bankrupt or insolvent according to law, or if any assignment is made of the property of Coop for the benefit of creditors, or if a receiver, trustee in involuntary bankruptcy or other similar officer is appointed by a court of competent jurisdiction to take charge of any substantial part of the Improvements or Coop's interest in the Leased Land, or if a petition is filed for the reorganization of Coop under any provisions of the Bankruptcy Act now or hereafter enacted, or if Coop files a petition for such reorganization, or for arrangements under any provision of the Bankruptcy Act now or hereafter enacted and providing a plan for a debtor to settle, satisfy or extend the time for payment of debts.

**11.4 A DEFAULT (UNCURED VIOLATION) GIVES CLT THE RIGHT TO TERMINATE THE LEASE OR EXERCISE ITS PURCHASE OPTION:**

a) **TERMINATION:** In the case of any of the events of default described above, CLT may terminate this lease and initiate summary proceedings against Coop under applicable law, and CLT shall have all the rights and remedies consistent with such laws and resulting court orders to enter the Leased Land and Improvements and repossess the entire Leased Land and Improvements, and expel Coop, its members and any others claiming rights through Coop. In addition, CLT shall have such additional rights and remedies as are permitted by law to recover from Coop arrears of rent and damages from any preceding breach of any covenant of this Lease. If this Lease is terminated by CLT pursuant to an Event of Default, then, as provided in Section 6.6 above, upon thus assuming title to the Improvements, CLT shall pay to Coop and any Permitted Mortgagee an amount equal to the Purchase Option Price calculated in accordance with Section 9.6 above, as of the time of reversion of ownership, less the total amount of any unpaid Lease Fee and any other amounts owed to the CLT under the terms of this Lease and all reasonable costs (including reasonable attorneys' fees) incurred by CLT in pursuit of its remedies under this Lease.

If CLT elects to terminate the Lease, then the Permitted Mortgagee shall have the right (subject to Article 7 above and the attached Exhibit: Permitted Mortgages) to postpone and extend the specified date for the termination of the Lease for a period sufficient to enable the Permitted Mortgagee or its designee to acquire Coop's interest in the Improvements and the Leased Land by foreclosure of its mortgage or otherwise.

b) **EXERCISE OF OPTION:** In the case of any of the events of default described above, Coop hereby grants to the CLT (or its assignee) the option to purchase the Improvements for the Purchase Option Price as such price is defined in Article 9 above. Within 30 days

after the expiration of any applicable cure period as established in Sections 11.1 or 11.2 above or within 30 days after any of the events constituting an Event of Default under Section 11.3 above, CLT shall notify the Coop and the Permitted Mortgagee(s) of its decision to exercise its option to purchase under this Section 11.4(b). Not later than ninety (90) days after the CLT gives notice to the Coop of the CLT's intent to exercise its option under this Section 11.4(b), the CLT or its assignee shall purchase the Improvements for the Purchase Option Price.

11.5 WHAT HAPPENS IF CLT DEFAULTS: CLT shall in no event be in default in the performance of any of its obligations under the Lease unless and until CLT has failed to perform such obligations within 60 days, or such additional time as is reasonably required to correct any default, after notice by Coop to CLT properly specifying CLT's failure to perform any such obligation.

#### **ARTICLE 12: MEDIATION AND ARBITRATION**

12.1 MEDIATION OR ARBITRATION CAN BE UTILIZED: Nothing in this Lease shall be construed as preventing the parties from utilizing any process of mediation or arbitration in which the parties agree to engage for the purpose of resolving a dispute.

12.2 COST OF MEDIATION OR ARBITRATION SHALL BE SHARED: Coop and CLT shall each pay one half (50%) of any costs incurred in carrying out mediation or arbitration in which they have agreed to engage.

#### **ARTICLE 13: GENERAL PROVISIONS**

13.1 COOP'S MEMBERSHIP IN CLT: The Members of the Coop shall automatically be regular voting members of the CLT.

13.2 NOTICES: Whenever this Lease requires either party to give notice to the other, the notice shall be given in writing and delivered in person or mailed, by certified or registered mail, return receipt requested, to the party at the address set forth below, or such other address designated by like written notice:

If to CLT: \_\_\_\_\_ (name of CLT)

with a copy to: \_\_\_\_\_ (CLT's attorney)

If to Coop: \_\_\_\_\_ (name of Coop)

with a copy to: \_\_\_\_\_ (Coop's attorney)

All notices, demands and requests shall be effective upon being deposited in the United States Mail or, in the case of personal delivery, upon actual receipt.

13.3 SEVERABILITY AND DURATION OF LEASE: If any part of this Lease is unenforceable or invalid, such material shall be read out of this Lease and shall not affect the validity of any other part of this Lease or give rise to any cause of action of Coop or CLT against the other, and the remainder of this Lease shall be valid and enforced to the fullest extent permitted by law. It is the intention of the parties that CLT's option to purchase and all other rights of both parties under this Lease shall continue in effect for the full term of this Lease and any renewal thereof, and shall be considered to be coupled with an interest. In the event any such option or right shall be construed to be subject to any rule of law limiting the duration of such option or right, the time period for the

exercising of such option or right shall be construed to expire 20 years after the death of the last survivor of the following persons:

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***NOTE: List an identifiable group of small children, e.g., the children living as of the date of this Lease of any of the directors or employees of a specified corporation.***

13.4 RIGHT OF FIRST REFUSAL IN LIEU OF OPTION: If the provisions of the purchase option set forth in Article 10 of this Lease shall, for any reason, become unenforceable, CLT shall nevertheless have a right of first refusal to purchase the Improvements at the highest documented bona fide purchase price offer made to Coop. Such right shall be as specified in Exhibit FIRST REFUSAL. Any sale or transfer contrary to this Section, when applicable, shall be null and void.

13.5 WAIVER: CLT may grant waivers of any terms of this Lease, but such waivers must be in writing and signed by CLT before becoming effective. The failure of CLT to take action with respect to any breach of any such requirement or restriction shall not be deemed to be a waiver of such requirement or restriction with regard to any subsequent breach of such requirement or restriction, or of any other requirement or restriction in the Lease.

The subsequent acceptance of Lease Fee payments by CLT shall not be deemed to be a waiver of any preceding breach by Coop of any requirement or restriction in this Lease, other than the failure of the Coop to pay the particular Lease Fee so accepted, regardless of CLT's knowledge of such preceding breach at the time of acceptance of such Lease Fee payment.

13.6 CLT'S RIGHT TO PROSECUTE OR DEFEND: CLT shall have the right, but shall have no obligation, to prosecute or defend, in its own or the Coop's name, any actions or proceedings appropriate to the protection of its own or Coop's interest in the Leased Land. Whenever requested by CLT, Coop shall give CLT all reasonable aid in any such action or proceeding.

13.7 CONSTRUCTION: Whenever in this Lease a pronoun is used it shall be construed to represent either the singular or the plural, masculine or feminine, as the case shall demand.

13.8 HEADINGS AND TABLE OF CONTENTS: The headings, subheadings and table of contents appearing in this Lease are for convenience only, and are not a part of this Lease and do not in any way limit or amplify the terms or conditions of this Lease.

13.9 PARTIES BOUND: This Lease sets forth the entire agreement between CLT and Coop with respect to the leasing of the Land; it is binding upon and inures to the benefit of these parties and, in accordance with the provisions of this Lease, their respective successors in interest. This Lease may be altered or amended only by written notice executed by CLT and Coop or their legal representatives or, in accordance with the provisions of this Lease, their successors in interest.

13.10 GOVERNING LAW: This Lease shall be interpreted in accordance with and governed by the laws of \_\_\_\_\_ [name of state]. The language in all parts of this Lease shall be, in all cases, construed according to its fair meaning and not strictly for or against CLT or Coop.

13.11 RECORDING: The parties agree, as an alternative to the recording of this Lease, to execute a so-called Notice of Lease or Short Form Lease in form recordable and complying with applicable law and reasonably satisfactory to CLT's attorneys. In no event shall such document state the rent or other charges payable by Coop under this Lease; and any such document shall expressly state that it is executed pursuant to the provisions contained in this Lease, and is not intended to vary the terms and conditions of this Lease.

IN WITNESS WHEREOF, the parties have executed this Lease at \_\_\_\_\_ on the day and year first written above.

## EXHIBITS

### Exhibit LEASED LAND

[This exhibit should present the full legal description of the leased land, exactly as it is described in the deed held by the CLT.]

### Exhibit DEED

[Improvements only]

### Exhibit ZONING

### Exhibit: PERMITTED MORTGAGES

The provisions set forth in this Exhibit shall be understood to be provisions of Sections 7.4 and 7.5 of the Lease. All terminology used in this Exhibit shall have the meaning assigned to it in the Lease.

**A. OBLIGATIONS OF PERMITTED MORTGAGEE.** Any Permitted Mortgagee shall be bound by each of the following requirements unless the particular requirement is removed, contradicted or modified by a rider to this Lease signed by the Coop and the CLT to modify the terms of the Lease during the term of the Permitted Mortgage.

1. If Permitted Mortgagee sends a notice of default to the Coop because the Coop has failed to comply with the terms of the Permitted Mortgage, the Permitted Mortgagee shall, at the same time, send a copy of that notice to the CLT. Upon receiving a copy of the notice of default and within that period of time in which the Coop has a right to cure such default (the “cure period”), the CLT shall have the right to cure the default on the Coop’s behalf, provided that all current payments due the Permitted Mortgagee since the notice of default was given are made to the Permitted Mortgagee.
2. If, after the cure period has expired, the Permitted Mortgagee intends to accelerate the note secured by the Permitted Mortgage or begin foreclosure proceedings under the Permitted Mortgage, the Permitted Mortgagee shall first notify CLT of its intention to do so, and CLT shall then have the right, upon notifying the Permitted Mortgagee within thirty (30) days of receipt of such notice, to acquire the Permitted Mortgage by paying off the debt secured by the Permitted Mortgage.
3. If the Permitted Mortgagee acquires title to the Improvements through foreclosure or acceptance of a deed in lieu of foreclosure, the Permitted Mortgagee shall give CLT written notice of such acquisition and CLT shall then have an option to purchase the Improvements from the Permitted Mortgagee for the full amount owing to the Permitted Mortgagee under the Permitted Mortgage. To exercise this option to purchase, CLT must give written notice to the Permitted Mortgagee of CLT’s intent to purchase the Improvements within thirty (30) days following CLT’s receipt of the Permitted Mortgagee’s notice. CLT must then complete the purchase of the Improvements within sixty (60) days of having given written notice of its intent to purchase. If CLT does not

complete the purchase within this 60-day period, the Permitted Mortgagee shall be free to sell the Improvements to another person.

4. Nothing in the Permitted Mortgage or related documents shall be construed as giving Permitted Mortgagee a claim on CLT's interest in the Leased Land, or as assigning any form of liability to the CLT with regard to the Leased Land, the Improvements, or the Permitted Mortgage.
5. Nothing in the Permitted Mortgage or related documents shall be construed as rendering CLT or any subsequent Mortgagee of CLT's interest in this Lease, or their respective heirs, executors, successors or assigns, personally liable for the payment of the debt secured by the Permitted Mortgage or any part thereof.
6. The Permitted Mortgagee shall not look to CLT or CLT's interest in the Leased Land, but will look solely to Coop, Coop's interest in the Leased Land, and the Improvements for the payment of the debt secured thereby or any part thereof. (It is the intention of the parties hereto that CLT's consent to such the Permitted Mortgage shall be without any liability on the part of CLT for any deficiency judgment.)
7. In the event any part of the Security is taken in condemnation or by right of eminent domain, the proceeds of the award shall be paid over to the Permitted Mortgagee in accordance with the provisions of Article 8 hereof.
8. CLT shall not be obligated to execute an assignment of the Lease Fee or other rent payable by Coop under the terms of this Lease.

**B. RIGHTS OF PERMITTED MORTGAGEE.** The rights of a Permitted Mortgagee as referenced under Section 7.5 of the Lease to which this Exhibit is attached shall be as set forth below.

1. Any Permitted Mortgagee shall, without further consent by CLT, have the right to (a) cure any default under this Lease, and perform any obligation required under this Lease, such cure or performance being effective as if it had been performed by Coop; (b) acquire and convey, assign, transfer and exercise any right, remedy or privilege granted to Coop by this Lease or otherwise by law, subject to the provisions, if any, in the Permitted Mortgage, which may limit any exercise of any such right, remedy or privilege; and (c) rely upon and enforce any provisions of the Lease to the extent that such provisions are for the benefit of a Permitted Mortgagee.
2. A Permitted Mortgagee shall not be required, as a condition to the exercise of its rights under the Lease, to assume personal liability for the payment and performance of the obligations of the Coop under the Lease. Any such payment or performance or other act by Permitted Mortgagee under the Lease shall not be construed as an agreement by Permitted Mortgagee to assume such personal liability except to the extent Permitted Mortgagee actually takes possession of the Improvements and Leased Land. In the event Permitted Mortgagee does take possession of the Improvements and Leased Land and thereupon transfers such property, any such transferee shall be required to enter into a written agreement assuming such personal liability and upon any such assumption the Permitted Mortgagee shall automatically be released from personal liability under the Lease.
3. In the event that title to the estates of both CLT and Coop are acquired at any time by the same person or persons, no merger of these estates shall occur without the prior

written declaration of merger by Permitted Mortgagee, so long as Permitted Mortgagee owns any interest in the Security or in a Permitted Mortgage.

4. If the Lease is terminated for any reason, or in the event of the rejection or disaffirmance of the Lease pursuant to bankruptcy law or other law affecting creditors' rights, CLT shall enter into a new lease for the Leased Land with the Permitted Mortgagee (or with any party designated by the Permitted Mortgagee, subject to CLT's approval, which approval shall not be unreasonably withheld), not more than thirty (30) days after the request of the Permitted Mortgagee. Such lease shall be for the remainder of the term of the Lease, effective as of the date of such termination, rejection or disaffirmance, and upon all the terms and provisions contained in the Lease. However, the Permitted Mortgagee shall make a written request to CLT for such new lease within sixty (60) days after the effective date of such termination, rejection or disaffirmance, as the case may be. Such written request shall be accompanied by a copy of such new lease, duly executed and acknowledged by the Permitted Mortgagee or the party designated by the Permitted Mortgagee to be the lessee thereunder. Any new lease made pursuant to this Section shall have the same priority with respect to other interests in the Land as the Lease. The provisions of this Section shall survive the termination, rejection or disaffirmance of the Lease and shall continue in full effect thereafter to the same extent as if this Section were independent and an independent contract made by CLT, Coop and the Permitted Mortgagee.

5. The CLT shall have no right to terminate the Lease during such time as the Permitted Mortgagee has commenced foreclosure in accordance with the provisions of the Lease and is diligently pursuing the same.

6. In the event that CLT sends a notice of default under the Lease to Coop, CLT shall also send a notice of Coop's default to Permitted Mortgagee. Such notice shall be given in the manner set forth in Section 13.2 of the Lease to the Permitted Mortgagee at the address which has been given by the Permitted Mortgagee to CLT by a written notice to CLT sent in the manner set forth in said Section 13.2 of the Lease.

7. In the event of foreclosure sale by a Permitted Mortgagee or the delivery of a deed to a Permitted Mortgagee in lieu of foreclosure in accordance with the provisions of the Lease, at the election of the Permitted Mortgagee the provisions of Article 9, Sections 9.1 through 9.8 shall be deleted and thereupon shall be of no further force or effect as to only so much of the security so foreclosed upon or transferred.

8. Before becoming effective, any amendments to this Lease must be approved in writing by Permitted Mortgagee, which approval shall not be unreasonably withheld. If Permitted Mortgagee has neither approved nor rejected a proposed amendment within 60 days of its submission to Permitted Mortgagee, then the proposed amendment shall be deemed to be approved.

### **Exhibit FIRST REFUSAL**

Whenever any party under the Lease shall have a right of first refusal as to certain property, the following procedures shall apply. If the owner of the property offering it for sale ("Offering Party") shall within the term of the Lease receive a bona fide third party offer to purchase the property which such Offering Party is willing to accept, the holder of the right of first refusal (the "Holder") shall have the following rights:

a) Offering Party shall give written notice of such offer (“the Notice of Offer”) to Holder setting forth (a) the name and address of the prospective purchaser of the property, (b) the purchase price offered by the prospective purchaser and (c) all other terms and conditions of the sale. Holder shall have a period of forty-five (45) days after the receipt of the Notice of Offer (“the Election Period”) within which to exercise the right of first refusal by giving notice of intent to purchase the property (“the Notice of Intent to Purchase”) for the same price and on the same terms and conditions set forth in the Notice of Offer. Such Notice of Intent to Purchase shall be given in writing to the Offering Party within the Election Period.

b) If Holder exercises the right to purchase the property, such purchase shall be completed within sixty (60) days after the Notice of Intent to Purchase is given by Holder (or if the Notice of Offer shall specify a later date for closing, such date) by performance of the terms and conditions of the Notice of Offer, including payment of the purchase price provided therein.

c) Should Holder fail to exercise the right of first refusal within the Election Period, then the Offering Party shall have the right (subject to any other applicable restrictions in the Lease) to go forward with the sale which the Offering Party desires to accept, and to sell the property within one (1) year following the expiration of the Election Period on terms and conditions which are not materially more favorable to the purchaser than those set forth in the Notice. If the sale is not consummated within such one-year period, the Offering Party's right so to sell shall end, and all of the foregoing provisions of this section shall be applied again to any future offer, all as aforesaid. If a sale is consummated within such one-year period, the purchaser shall purchase subject to the Holder having a renewed right of first refusal in said property.

### **Other Exhibits to be Attached as Appropriate**

Exhibit RESTRICTIONS [To be attached when necessary to stipulate use restrictions not included under Zoning]

Exhibit INITIAL APPRAISAL [To be attached if Lease contains an “appraisal-based” resale formula]

## Commentary on the Model CLT-Coop Lease

This commentary is designed to provide information regarding (1) the considerations that have gone into drafting the Model CLT-Coop Lease – and (2) the ways in which those drafting their own CLT-coop ground lease may have reason to diverge from the model in adapting it to their own situations. The commentary also touches on certain legal issues that may require research under the laws of the particular jurisdiction in which the CLT will be created.

Headings in this commentary refer to specific articles or sections of the Model Lease as presented in Chapter 15-A. The section headings in the Model have been expanded in order to give readers a more immediate sense of the gist of the section. In the commentary, more concise headings are used. It should be noted that section 13.8 states explicitly that all headings are for convenience only and “do not in any way limit or amplify the terms or conditions of this Lease.”

### Recitals

The recitals, or introductory “*whereas*” clauses, set out background information about the parties to the transaction and their motivations. The clauses in this model probably apply to the majority of CLTs and limited equity housing coops, but can and should be modified or supplemented to better fit the goals and purposes of the particular CLT and particular coop that are entering into the lease agreement.

There are several important legal effects of these clauses to bear in mind. If there is ever a dispute over the legal validity of some other section of the Lease, the understanding of the parties at the time of the original transaction, including the Coop’s willingness to give up certain typical rights of real estate ownership in return for the benefits provided by the CLT, may play a significant role in a court’s analysis.

All statements of the CLT’s purposes, including those that make reference to specific income levels, should be consistent with the CLT’s corporate purposes as stated in the Articles of Incorporation and as represented to the IRS in applying for recognition of tax-exempt status (see Chapters 4 and 6). In the Model, the references to the purposes of the CLT are framed with reference to “low and moderate income households.” Some CLTs may need to modify this language. References to the Coop’s purposes should also be consistent with the corporate purposes stated in the Coop’s articles of incorporation.

### Definitions

The terms defined here are key to a clear understanding of the most important relationships, rights and responsibilities established by the Lease. If you use these terms differently in your lease, the definitions should be adjusted accordingly. If you replace these terms with others you should of course define the others in this section. You may also want to add definitions of terms that are key to the particular resale formula that you decide to use (see commentary on Article 10).

In particular, note that, if the Coop is a not-for-profit corporations rather than a shareholder corporation, the definition of “members” should be modified accordingly.

## **ARTICLE 1: Leasing of Rights to the Land**

### **Section 1.1: CLT Leases Land to Coop**

Exhibit LEASED LAND is a legal description of the property being leased. Care should be taken to include as appurtenant to the Leased Land the right to use any easements or other benefits serving the Leased Land. Rights to use utilities and other physical matters serving the buildings on the Leased Land should also be included, as well as rights of access to repair and maintain such utilities.

This section also states that the Leased Land is leased “as is,” so that the CLT is making no representations as to the quality of title to the Leased Land. The risk of a title problem is of concern to both the CLT and the Coop, and the Coop’s lender is likely to require a title certification or title search running in favor of the lender in the event of a loss due to a title problem. This is a cost typically borne by the buyer of property, and similarly the risk (and therefore by implication the cost of investigation), has been allocated to the Coop here. The parties could, of course, change this allocation.

### **1.2: Reservation of Mineral Rights**

This reservation of mineral rights is probably relevant only to rural situations. Where mineral or other subsurface rights might be of particular value, this section could be altered or expanded. For example, rather than prohibiting the CLT from removing minerals from the leased Land without the Coop’s permission, the CLT might be allowed to proceed with removal without permission if its actions do not disrupt the Homeowner’s use of the property or if it takes certain steps to minimize the disruption and/or compensate the Coop.

In any case where the CLT does not in fact own the mineral rights, this section must of course be revised to accord with the facts.

In addition to mineral rights, there may be other types of property rights that need to be clarified in a particular area. For example, if some of the Leased Land is wooded, are the timber rights being leased to the Coop or are they being reserved to the CLT? If there is farmland, are there standards for farming practices that are important to the CLT? Any reservation of rights to the CLT or regulation of the Coop’s activities should be spelled out as clearly as possible to avoid conflicts and confusion in the future.

## **ARTICLE 2: Term of Lease; Change of Land Owner**

### **2.1 and 2.2: Principal Term and Coop’s Option to Extend**

The Model Lease uses a 99-year lease term because this is typically the longest lease term allowable before there is a question of whether the ground lessee’s property interest is really in the nature of fee simple ownership. As a general rule, the longer the leasehold term the more closely the lessee’s property rights resemble those of a full fee simple owner of the Land and Improvements. Also, as noted in Chapter 20, “Financing CLT Homes,” the longer leasehold term minimizes lenders’ concerns regarding the potential impact of the end of the lease term on their security.

The Coop’s option to renew the Lease extends the potential duration of the Coop’s security of tenure even further. It is of course true that a community’s needs and goals may change during the term of a lease. A shorter lease term without a renewal option would give the CLT, as representative of community interest, a more certain opportunity to review whether the use permitted under the Lease still meets the needs of that community. In balancing these interests, most CLTs have opted for a 99-year initial term, and most have

followed the (single-family) Model Lease in providing for renewal of such a term.

In most jurisdictions, a 99-year lease term is allowable. However, in some states, the option to renew at the end of a 99-year term is a remote interest in property which is invalid by statute (as in California) or by common law application of the Rule Against Perpetuities (see discussion of Rule Against Perpetuities regarding Section 14.4 below; see also Chapter 9, “Enforceability of the CLT’s Preemptive Right”). In some cases the rule can technically be satisfied by making the renewal automatic. If in a particular state there is no way around this problem, then the choice is either to shorten the lease term to a legally acceptable length or not to provide a renewal option and leave the question of renewal to the decision of the parties at the end of the 99-year initial term.

A lease without an option to renew the lease on the original terms would leave the Coop in a weakened bargaining position at the end of the lease term. On the other hand, after 99 years, some of the terms of the Lease might no longer make much sense or might be unduly disadvantageous to the CLT, so there might be legitimate reasons to refuse a renewal on the same terms. In Section 2.2 a middle ground has been chosen, providing for a full 99-year term with an option to renew, but giving the CLT some flexibility to modify terms upon renewal so long as the modifications are not “materially adverse” to the Coop’s rights. The concept of “materially adverse” is admittedly open to interpretation, but is intended to distinguish changes which would cause some significant hardship to the Coop (e.g., a substantial increase in the Lease Fee) from generally benign changes (e.g., a new method of notice).

Note that the CLT is required to give written notice to the Coop, between 180 and 365 days prior to expiration, regarding the impending expiration of the Lease term. If the Coop wishes to renew the Lease, it must then, within 60 days, give written notice to CLT, exercising the option to extend. The requirement that the CLT give notice regarding impending expiration is intended to protect the Coop, whose members at the time may have no clear knowledge of when the Lease expires or of exactly what must be done to extend it.

### **2.3: Change of Land Owner**

By giving the Coop a right of first refusal in the event of a sale of the Land to other than a public agency or nonprofit organization carrying out the CLT’s goals, the Model Lease provides an extra measure of security to the Coop. Some CLTs might choose to go a step further and give the Coop a right to buy for a limited (designed to be affordable) price in such a situation.

Note that the attachment “Exhibit FIRST REFUSAL” establishes specific terms for both the right of first refusal described in this section and the separate right of first refusal granted *to the CLT* in Section 13.4. The Exhibit gives the holder of the right 45 days in which to notify the seller of its intent to purchase. The holder then has 60 days in which to complete the purchase. (CLT’s seeking to facilitate FHA mortgage insurance for single-family homebuyer-lessees have noted that FHA regulations limit the period in which such a right can be exercised to 45 days. At least as the language is understood by FHA, however, the right is “exercised” when the holder gives notice of intent to purchase.

## **ARTICLE 3: Use of Leased Land**

### **3.1: Leased Land Must Be Used for Limited Equity Cooperative**

Needless to say, this specifically restrictive section does not appear in the single-family

model. Along with the provisions of Article 10, this section requires that the corporation signing the lease as lessee will continue to operate as a limited equity housing cooperative on the Leased Land. If the original coop-lessee is eventually permitted by the CLT to transfer the improvements to (for instance) a nonprofit that will operate the property as conventional rental property, Section 9.8 provides for the negotiation of new lease terms appropriate for use for purposes other than those of a limited equity cooperative.

### **3.2: Residential Use Only**

The Coop's primary use is of course to be residential. Also allowed under this section are uses that the local zoning code would permit as "incidental" to residential use. Such incidental uses are typically home occupations, such as haircutting, professional offices with minimal or no staff, and the like.

If the CLT wishes to impose any restrictions on use that are not currently compelled by law, it can add them in an "Exhibit RESTRICTIONS." Such an Exhibit might be used to spell out such matters as parking regulations, and might also describe a process for modifying such regulations from time to time without modifying the body of the Lease.

Use restrictions raise a number of important choices for the CLT. A private agreement like a lease can prohibit some uses permitted by local zoning, but cannot permit uses which local zoning prohibits. Therefore, the effect of Section 3.2 is to "freeze" the allowable uses according to zoning at the time the Lease begins unless zoning itself later becomes more restrictive. The CLT must consider whether the existing zoning furthers its policies and priorities. It must also consider whether uses that come to be permitted by local zoning in the future should automatically be permitted under the Lease.

### **3.3: Responsible Use and Compliance with Law**

This section obligates both the Coop as a corporation and its members as individuals to use the Leased Land and the Improvements in ways that will not cause harm to others or create any public nuisance. The section also establishes as a condition of the Lease the requirement that the Leased Land and Improvements be maintained in accordance with all applicable laws, so that a violation of any such law will constitute a default under the Lease. In addition, the Model explicitly provides that the property must be maintained "in such condition as is required to maintain the insurance coverage required by Section 8.4 of this Lease." This provision is implicit in Section 8.4 itself but is included here to emphasize it as one of several significant criteria for required maintenance.

### **3.4: Responsible for Others**

This section makes it clear that ultimate responsibility for the behavior of individuals on the Leased Land – whether they are Members or guests of Members – remains the Coop's. Thus the Coop is responsible for addressing any violations of use restrictions on the part of individuals.

### **3.5: Permission for Subleasing to Non-Members**

This section states the requirement that the CLT must give permission for any subleasing or sale of the Coop's rights to any entity other than Members of the Coop. Article 10 deals with the subleases (proprietary leases) issued to Members.

### **3.6: Inspection**

This section involves sensitive policy questions the treatment of which may be negotiated

by the particular CLT and Coop. The parties must agree on the exact nature of the inspection rights that the CLT will retain. They must agree on how frequently inspections should be permitted and how much advance notice should be required. They must also agree on whether the right to inspect the Leased Land will include or exclude the right to inspect the interiors of buildings. In the Model CLT-Coop Lease, the right to inspect the interiors of buildings is explicitly excluded. The CLT should consider whether it will allow the additional degree of privacy provided by this exclusion, or whether it feels the right to inspect interiors of buildings is necessary if the CLT is to carry out its stewardship responsibilities. An alternative approach might be to permit CLT inspection of all common areas, both indoors and out, but not the interiors of Members' apartments.

The Model does give the CLT the right to inspect the interiors of buildings in the unlikely event that it has received an intent-to-sell notice from the Coop as provided in section 9.3.

It is important to emphasize that, by establishing a right to inspect the Leased Land, a CLT does not commit itself to a policy of regular inspections. CLTs may adopt the policy of exercising the right only when they have reason to think that serious damage is being done to the Improvements or that the Coop's use of the Leased Land is endangering others. It should also be noted that conventional mortgages give the mortgagee a comparable (and often less specifically limited) right of inspection.

### **3.7: Right to Quiet Enjoyment**

This section is intended to comfort the Coop and its Members by declaring that the CLT's role should be limited to avoid undue interference with the enjoyment of the Leased Land by the Coop and its Members. The term "quiet enjoyment," has a technical legal connotation concerning the right to continued possession of real property without being "dispossessed" by any party.

## **ARTICLE 4: Lease Fee**

### **4.1: Amount of Lease Fee**

The approach to the lease fee taken with CLT single-family leases has changed over the years. In early versions of the single-family model, the fee was defined as the sum of a set of specified components, including the taxes on the land, as well as an "administrative charge" and a "land use charge." In later versions, taxes on the land are not charged to the lessee as a component of the lease fee (the lessee is required to pay them directly), and the "land use charge" and "administrative charge" are no longer distinguished from each other. This CLT-Coop lease follows the practice of treating the lease fee as a single amount paid to the CLT, with all taxes paid separately by the Coop.

### **4.2: Payment of Lease Fee**

CLT lease fees are normally paid on a monthly basis, like other regular housing costs but unlike some other types of ground rent, such as rents for agricultural land, which are often paid annually.

### **4.3: Calculation of Lease Fee**

This section describes the calculation of the Lease Fee in terms of two basic necessary considerations – fair rental value on the one hand and affordability on the other hand – but it does not spell out a detailed method for applying these considerations. As noted in Chapter 13, "Establishing and Collecting Fees," there is no precise method of calculating the amount

by which fair rental value is reduced by the special restrictions imposed by a CLT lease; nonetheless, it is normally assumed that the amount of a CLT lease fee should be *at least somewhat less than* what the fair rental value would be if there were no special restrictions. It is important to establish this principle in the Lease in order to justify the provision, in section 4.6 below, for *increasing* the fee if restrictions are ever removed.

#### **4.4: Reduction or Suspension of Lease Fee**

This section recognizes the CLT's right to waive all or part of the Lease Fee in a hardship situation. Section 13.5 insures that a waiver or reduction by the CLT in one instance will not obligate it to make the same arrangement in a later instance.

#### **4.5: Periodic Increase of Fees**

This section allows the CLT to increase the Lease Fee from time to time, provided the total increase since the date of the execution of the Lease does not exceed the increase in the Consumer Price Index over that time. Several variations of this approach are possible. You may *require* that either or both of the fees be recalculated at specified intervals, rather than just preventing the CLT from increasing them more frequently than once in a specified number of years. You may also choose to call for periodic recalculation of the fee through the same process described in section 4.3, rather than through the CPI-based process.

It should be noted that some mortgage lenders and mortgage insurers may insist on tighter limitations of the CLT's right to increase the Lease Fee than the CLT would otherwise choose, or may insist on a right to approve any increase in the Fee. Such lender-imposed limitations, if necessary, should be established in a rider to the Lease, applicable only during the term of the mortgage in question, rather than in the body of the Lease.

#### **4.6: Increase in Lease Fee if Restrictions are Removed**

This important section allows the CLT to increase the Lease Fee in the event that resale and use restrictions are removed from the lease as a result of a mortgage foreclosure or for any other reason. Since the amount of the Lease Fee has been calculated as the fair rental value of the land, as restricted by the Lease and adjusted for affordability, it is reasonable to allow this increase to reflect the unrestricted value of the land in a situation where restrictions are removed. The limitation on the initial amount of the increased fee to a specified dollar amount is intended to address the concerns of mortgagees or buyers who might acquire the Improvements pursuant to foreclosure.

#### **4.7: Late Payment Penalty**

As the penalty is structured here, interest can be charged for late payment as soon as the "due date" has passed, but will be forgiven if payment is made within 30 days of the due date. This approach gives the CLT a bit of added leverage when it notifies the Coop, during the 30-day period, that the payment has not been received.

#### **4.8: Collection of Unpaid Fees from Proceeds of Sale**

This section explicitly provides for collection by the CLT of any unpaid lease fees out of the Coop's proceeds if the Improvements are sold. The last sentence of the section strengthens the CLT's hand in this matter by providing for a lien on the Improvements. Nonetheless, in a situation where a significant amount is owed, the CLT should consult with its attorney regarding actions that may need to be taken to ensure full enforceability of this provision.

## **ARTICLE 5: Taxes and Assessments**

### **5.1 and 5.2: Taxes and Assessments**

These sections assign responsibility for taxes on the Leased Land as well as on the Improvements directly to the Coop. As noted above, it is also possible for the CLT to pay the taxes on the land but to pass this cost on to the Coop as a component of the Lease Fee. See Chapter 13, “Establishing and Collecting Fees,” for discussion of the advantages and disadvantages of the two approaches.

### **5.3: Coop’s Right to Contest**

Jurisdictions may differ somewhat on whether a ground lessee can contest real estate taxes in its own name. For example, in Massachusetts, any tenant having an obligation to pay more than 50% of the taxes on a property can contest real estate taxes in its own right (although a tenant, unlike an owner, must pay the taxes first and then file for an abatement).<sup>1</sup> This section 6.3 clarifies that Coop can do so, even if the law does not grant such a right, by providing that the CLT shall join in such abatement proceeding in response to a “reasonable request from Coop for assistance in this matter”.

### **5.4: Payments in Event of Delinquency**

This section specifically allows the CLT to add to the Lease Fee any delinquent taxes or assessments on the Improvements and/or the Land.

## **ARTICLE 6: The Improvements**

### **6.1: Ownership of Improvements**

The Improvements are owned by the Coop. This separation of ownership of land and buildings is at the core of the CLT approach to ownership (see Chapter 10, “Legal Issues Re. CLT Ownership,” where this principle is discussed, along with some variations from it). Nevertheless, the ownership of the Improvements is intended to be subject and subordinate to the Lease; that is, the Lease imposes some limits on the usual rights of ownership of the Improvements. Especially important is the question of whether at the end of the lease term (or sooner) the Improvements – or any permanent part of the Improvements – can be “severed” from the Leased Land and moved elsewhere. Commercial Leases typically prohibit such severance and provide for a forfeiture of the title to any leasehold improvements to the lessor at the end of the lease term. Section 6.6 follows this practice. However, in some states a ground lessee’s ownership of the Improvements may in part turn on having the right to sever. (See comments on Section 6.6 below.)

### **6.2: Purchase of Improvements by Coop**

A deed is used for conveyance rather than a bill of sale to signify that the Improvements are to be considered as real (rather than personal) property. However, some jurisdictions may consider the Improvements technically to be personal property, in which case a bill of sale will be the appropriate instrument.

### **6.3: Construction and Alteration**

All CLTs have a fundamental interest in preserving the quality of the housing on its land and protecting future residents of the property against inferior work. CLTs will differ,

however, regarding the type of work for which they will want CLT approval to be required. You may therefore want to revise clause “d” in the first paragraph of the section to redefine the type of work that must be approved. You may also want to modify the approval process laid out in the second paragraph.

It should be emphasized that this section 6.3 does not deal with the question of whether construction or alteration will affect the Purchase Option Price described in Article 9. This question is addressed separately in section 9.7 below. It is possible to combine or coordinate the two approval processes, but it is important that the two issues – consent for construction as such and approval of a capital improvement credit – not be confused.

#### **6.4: Prohibition of Liens**

Liens are a potential threat to the CLT’s title to the Land and to the transferability of the Improvements, so the provisions of this section are designed to prohibit all liens (other than permitted mortgage liens). In some situations, however, some party may need to protect itself against non-payment by filing such liens. The provisions for “bonding-off” liens put the burden on the Coop to make arrangements for a source (other than the property) of payment of any meritorious claim while the claim is being resolved. Note that generally a “prohibition of liens” such as that contained in this section cannot defeat the rights of certain parties to obtain a lien under local law. Rather, the provision just bars the lessee from allowing such a lien to occur and remain in place.

#### **6.5: Maintenance and Services**

Supplementing the provisions of Section 3.3 with specific reference to the lessee-owned Improvements, these provisions are intended to see that the Improvements will remain in good condition, both to protect residents and to minimize the possible CLT liability. The section also explicitly establishes that the Coop is responsible not only for routine maintenance but for any major repairs or replacements that become necessary.

#### **6.6: Disposition of Improvements upon Expiration of Lease Term**

If the Lease were silent on the matter, in some jurisdictions the Coop might be able to “sever” the Improvements from the Leased Land and move them elsewhere when the Lease expires or terminates. Some CLTs do permit severance but specify certain conditions (e.g., Lessee must repair all damage to the Land). See Chapter 10, “Legal Issues Re. CLT Ownership,” for further discussion of this matter.

Regarding the CLT’s obligation to pay for the Improvements upon the reversion of ownership, this section provides explicitly for full payment to Permitted Mortgagees before any amount is paid to the Coop. It also explicitly holds the Coop responsible for clearing any liens on the Improvements at the time of reversion, or for reimbursing the CLT for its costs in clearing such liens, including attorney’s fees.

In this Model CLT-Coop Lease, as in the 2010 version of the model single-family lease, the CLT is required to pay for the Improvements regardless of whether the Lease has expired or has been terminated as a result of a default by Coop. However, some CLT leases (and early versions of the model single-family lease) impose this requirement *only* in the case of expiration of the full term of the Lease, leaving the CLT (or a successor lessor) without an obligation to pay for the Improvements if the Lease is “sooner terminated” as a result of a default by the lessee. CLTs should weigh the additional protection for the Coop that is provided by the approach used here against the additional protection for the CLT provided by

the alternative version. In any event, however, it should be noted that the CLT cannot terminate the lease without paying whatever is owed to – or otherwise accommodating the interests of – any Permitted Mortgagees (see “Permitted Mortgage Exhibit,” Section B).

## **ARTICLE 7: Financing**

For a thorough discussion of leasehold mortgages and the issues that they raise for mortgage lenders and for CLTs, see Chapter 20, “Financing CLT Homes.”

The CLT has important reasons for overseeing the Coop’s access to mortgage financing. Regarding any proposed mortgage financing, the CLT wants to be sure (a) that the mortgage lender is fully aware of the terms of the Lease, (b) that the CLT’s fee interest in the land is not mortgaged or otherwise endangered, (c) that the total amount of debt, the repayment schedule, and other terms of the loan are reasonable and manageable for the Coop without imposing an unaffordable burden on the lower-income Members, (d) that in the event of a mortgage default the CLT will have every possible opportunity to prevent foreclosure, not only for the sake of the Coop and its current Members but for the sake of preserving the public’s investment in the affordability of the housing, and (e) that, in the event a foreclosure is unavoidable, the CLT will have the best possible chance to regain control of the Improvements for future lower income owner-occupants.

For these reasons, the Lease allows only “Permitted Mortgages.” In past versions of the single-family model, a Permitted Mortgage was defined as any mortgage that was permitted in writing by the CLT *and* that included (in the mortgage document or related documents) certain provisions, protective of the CLT’s interest in the property, that are not common to conventional mortgages. In practice, however, CLTs generally agreed to permit mortgages for which these provisions were not written into the documents. The 2002 edition of the CLT Legal Manual contains a model Permitted Mortgage Agreement, which, it was suggested, CLTs should ask mortgagees to sign. However, such written agreements with mortgagees have continued to be rare. Therefore, both the 2010 single-family model and this Model CLT-Coop Lease take a somewhat different approach, as described in the commentary that follows.

### **Section 7.1 Definition of Permitted Mortgage**

Here the term “Permitted Mortgage” is defined simply as any mortgage that the CLT has permitted in writing.

### **Section 7.2 CLT Permits Original Mortgages by Signing Lease**

This section explicitly incorporates something that, in the past, has often been assumed but not explicitly stated. At the time when the Coop acquires the Improvements and the rights to the Leased Land, the CLT has usually been working closely with the Coop to see that appropriate financing is arranged. The CLT is necessarily in position to know what kind of financing has been arranged before the CLT proceeds to sign the Lease. For this reason it seems unnecessary to require the signing of a separate “permitted mortgage document” at that time. If the CLT finds the proposed mortgage financing unacceptable it will not sign the Lease.

### **Section 7.3 Permission for Refinancing or Other Subsequent Mortgages**

At any time subsequent to the closing of the original transaction it is possible for the Coop to seek refinancing or additional financing without the CLT necessarily being aware. In such

situations it is important that the Coop be required to provide essential information about the financing to the CLT and get specific written permission from the CLT before proceeding. Refinancing and second mortgage financing are a particular concern because they may allow the Coop to assume additional debt on terms that it cannot realistically manage – and may possibly result in total debt that is greater than the purchase option price. Careful lenders should of course share these concerns. In reality, however, lenders have sometimes made non-permitted loans to individual CLT homeowner/lessees without even realizing that a ground lease existed, much less that it contained resale price restrictions.

This section – like the comparable section in the 2010 model single family lease – requires that the Coop inform the CLT of the proposed terms and conditions of any such mortgage loan at least 15 business days prior to the expected closing of the loan. A CLT may wish to stipulate a different minimum number of days in the case of a coop. It may also wish to itemize the specific information that must be provided to the CLT – or may wish to revise the section to state that the Coop must notify the CLT of its intention and that the CLT will *then* inform the Coop of the specific information that it will require before approval can be granted.

#### **Section 7.4 Obligations of a Permitted Mortgagee**

By defining the basic obligations of a Permitted Mortgagee, this section establishes protections for CLT and Coop as conditions of the lease itself, unless CLT and Coop have executed a lease rider that modifies or contravenes the stated obligations. This approach departs from the strategy employed in past CLT leases, which asked that the mortgagee include these conditions in mortgage documents or sign a separate document agreeing to such protections. The reality in the past was that these conditions were actually *not* written into either the mortgage documents or separate agreements. What actually happened in most cases was that CLTs, after negotiating the most favorable terms possible, went ahead and permitted the mortgages anyway. In such situations, whatever conditions were agreed upon in negotiations between Permitted Mortgagee and CLT were often incorporated in lease riders (like the Fannie Mae Uniform CLT Ground Lease Rider) which were signed by the Coop and the CLT but not by the mortgagee. The current approach accepts the reality that a mortgagee may insist on such a lease rider. But, in turn, it establishes the obligations of a Permitted Mortgagee as conditions of the Lease, thereby defining an essential element of the collateral for the leasehold mortgage) except in so far as any of these obligations are removed or altered by a lease rider.

The current approach also eliminates the requirement that the “cure period” (the time in which the CLT has a right to cure a lessee’s mortgage default) must last a specified number of days – a definition that in the past was usually either ignored or modified by a lease rider. The cure period is now defined simply as “that period of time in which the *lessee itself* has a right to cure such default” (Exhibit: Permitted Mortgages, Section A-1).

It should be emphasized that any concessions made to specific mortgagees should be incorporated not in the lease itself but in a lease rider binding only for the life of the mortgage.

#### **Section 7.5 Rights of Permitted Mortgagees**

Like the obligations of a Permitted Mortgagee, the rights of a Permitted Mortgagee stated in the Permitted Mortgagee Exhibit referenced in this section can be modified or supplemented by a lease rider.

The rights stated in the exhibit are those that most careful lenders will insist on having guaranteed to them. The fact that the Lease does guarantee them only for *Permitted Mortgagees* provides some important protection for both the Coop and the CLT. If the CLT ever discovers that a lessee has in fact granted a mortgage that has *not* been permitted by the CLT, the mortgagee can be advised that it does not have the rights specifically assigned to Permitted Mortgagees by the Lease (including the right to prevent the termination of the Lease in the event of a default under the Lease by the lessee), and it can be advised that the mortgaging of the Improvements and leasehold interest without CLT's permission constitutes a default under the Lease which could lead to termination. Given these circumstances, it is likely that the mortgagee will choose to come to terms with the CLT.

#### **Section 7.6 CLT's Right to Proceeds in Excess of Purchase Option Price**

This provision addresses a situation that could arise if the Improvements are sold, pursuant to foreclosure, for an amount that would allow the Coop, after the mortgagee is paid in full, to realize proceeds in excess of what is permitted by the resale restrictions in Article 9. The enforceability of this provision may vary depending on state laws relating to foreclosure, but it remains important that the Lease contain language whereby, as far as is legally possible, the Coop explicitly gives up any claim to such excess proceeds.

### **ARTICLE 8: Liability, Insurance, Damage and Destruction, Eminent Domain**

Most of the provisions of this article are similar to standard provisions for liability and casualty matters found in most long-term leases. The Model is careful, however, to limit the value that can be taken away by the lessee and to protect the CLT's right to preserve the value invested in the Improvements as well as the land by the public.

For a discussion of liability issues affecting long-term ground lessors and ground lessees, see Chapter 10, "Legal Issues Re. CLT Ownership."

#### **Section 8.5 Damage or Destruction.**

This section calls for the CLT to help find a way to cover any costs that are not covered by insurance and not affordable for the Coop. If a way to cover these costs cannot be found that is acceptable to both parties, then the Coop can terminate the Lease. If the Lease is terminated, the Coop cannot receive more from the insurance proceeds than the Purchase Option Price allowed under Article 9, thus eliminating any possible incentive to use arson as a means of avoiding the equity limitations of the Lease. The section also ensures that if the Lease is terminated, "the expenses of enclosing or razing the remains of the Improvements and clearing debris" must be paid out of the insurance proceeds before any proceeds are paid to the Coop.

Note that in this section the Purchase Option price is to be determined "as of immediately prior to the damage." For CLTs with appraisal-based resale formulas, this situation may require an appraiser to calculate the value of what can no longer be observed. However, methods for such calculations have been developed and can be employed by a professional appraiser. The possible need for determining the value of something that has been lost or damaged is not unique to CLTs.

#### **Section 8.6 Eminent Domain**

In this section, provisions for allocating the amount of an award between CLT and Coop

are closely parallel to provisions for allocation of insurance proceeds in the event of damage or destruction as laid out in section 8.5 above.

## **ARTICLE 9: Transfer of Improvements**

### **Section 9.1 Intent**

The intent of this article is substantially different from that of the comparable article in CLT single-family leases, which deals with the almost inevitable eventual resale of a single family's home – either directly or through the CLT – to another income-qualified family, whereas the underlying assumption with the coop lease is that the coop, like the CLT, is intended to be a permanent institution, whose members may come and go as the institution remains. If the Improvements are ever to be transferred by the Coop, the situation is likely to be one in which either (a) the Coop is, in effect, being merged into a larger limited equity housing cooperative and is transferring ownership of the Improvements to the larger coop corporation, or (b) the Coop is unable to continue operation and will therefore be dissolved and must transfer the Improvements to some other entity. To our knowledge, CLTs have never actually dealt with situation “a,” though it would presumably be the preferable alternative. A few, however, have dealt with situation “b” – by reacquiring title to the Improvements and then operating the property as CLT-owned affordable rental housing, thus fulfilling the stated intent that the property will continue to provide affordable housing for low or moderate income people.

### **Section 9.2 Transfers Only to CLT or Approved Purchaser**

This section states explicitly that the Improvements and the Coop's interest in the Leased Land can be transferred *only* in accordance with the sections that follow and that any other “purported transfer” shall be null and void.

### **Section 9.3 Coop's Notice of Intent to Sell**

It is likely that the CLT will already have been a party to working out either a situation “a” or a situation “b” before receiving a formal Intent-to-Sell Notice, but the provision remains an important safeguard against a transfer not anticipated or approved by the CLT.

### **Section 9.4 Appraisal**

The appraisal described in this section is needed only in the unlikely event that the CLT has reason to believe that the as-if-unrestricted market value of the Improvements has declined to something *less than* the “Formula Price.” It should be emphasized that this section 9.4 will need to be modified if the resale price formula stated in section 9.7 is an “appraisal-based formula,” which will require that an appraisal be performed in order to determine the Formula Price.

### **Section 9.5 Approval of Potential Purchaser**

The guidelines for approval described here are intended to be open-ended and flexible enough to allow the parties to work through a hard-to-anticipate and potentially complicated resale scenario. Input from Coop Members is explicitly invited, since the future control of the members' homes is at stake.

### **9.6 CLT's Option to Purchase the Improvements**

The process and time-frame described in this section are much less tightly limited than those established by the single-family model lease for the resale of a single-family home. It is

assumed that, if it is ever necessary for the Coop to sell the Improvements, the CLT will want to work with the Coop and its Members to make appropriate arrangements. Since no time limit is established for this process, the CLT is allowed to retain its purchase option throughout the process regardless of how long it takes.

### **9.7 Determination of Purchase Option Price**

It should be noted that in early versions of the CLT single-family model lease, and in some earlier CLT-coop leases, the term “Purchase Option Price” was used to mean what is now identified as the “Formula Price.” The term “Actual Purchase Option Price” was then used to designate what is now called the “Purchase Option Price.” Not surprisingly the older practice resulted in some confusion and some drafting errors. It is strongly recommended that CLTs use the terms “Purchase Option Price” and “Formula Price” as used in this model.

The Section makes it clear that the Purchase Option Price is the maximum price that may be charged in any circumstances, regardless of whether the CLT has exercised its option or the Coop is selling the Improvements directly to another buyer.

### **9.8 Calculation of the Formula Price**

Most resale formulas established by CLT single-family leases are designed to give individual CLT homeowners a modest amount of equity build-up while keeping the home affordable for future buyers at the same approximate income level. These formulas usually allow resale prices to grow beyond the lessee’s original purchase price (the “base price”) by either giving the seller a specified percentage of market appreciation or an annual increment that is based either on a fixed percentage of the base price or on the percentage change in an index such as the consumer price index (see Chapter 12, “Resale Formula Design”). However, the particular “formula” stated in this section of the Model CLT-Coop Lease allows the Formula Price to increase beyond the base price only in so far as value has been added by approved capital improvements completed by the Coop. Depending on the extent to which the coop’s share values are allowed to appreciate – and on other circumstances of the particular Coop project – a CLT may decide to use one or another formula that would allow greater appreciation, or that would at least adjust the resale price for inflation.

### **9.9 Qualified Purchaser to Receive New Lease**

Since it is assumed that an approved purchaser will not necessarily be a limited equity housing cooperative, this section gives the CLT a good deal of discretion in setting the terms of a new lease to be issued to an “approved purchaser” that is not such a coop. Among other things the terms of article 10 would need to be substantially different in such a case.

## **ARTICLE 10: Coop’s Obligations and CLT’s Rights Regarding Operation Of the Coop**

All of the provisions of this article are specific to CLT ground lease situations in which the lessee is a limited equity housing cooperative. Some of the provisions included here – in particular those relating to financial management – might be laid out in a separate management contract between the parties rather than in the lease.

### **10.1 CLT Approval of Coop Bylaws and Proprietary Lease**

Because the CLT’s purpose in leasing land to the Coop is to support a limited equity housing cooperative that operates in a certain way to provide a certain kind of ownership

opportunity for people in certain income categories, the CLT is necessarily concerned with the rules by which the Coop will operate, which are laid out in the Coop's Bylaws and in the Proprietary Leases issued to Members. The CLT would not lease land to a housing cooperative whose Bylaws and standard Proprietary Lease it did not approve. It follows that if either of these documents is to be changed, the CLT must approve the change.

### **10.2 Income and Affordability Requirements**

The Coop will probably have entered into some form of affordability agreement with a funder that is subsidizing the project for some specified mix of income levels. The exhibit referenced here may consist of or include such an agreement (identified by whatever title does in fact appear on the document), but it may also consist of or include a document drafted by the CLT to state the requirements established by the funder and perhaps to extend those requirements to apply for the entire term of the lease and/or to apply to a greater number of shareholders and/or units than the funder agreement covers.

### **10.3 Compliance with Applicable Laws and Regulations**

The significant effect of this section is to make any violation of such laws a default under the terms of the lease, giving the CLT a kind of leverage in ensuring compliance that it would not otherwise have.

### **10.4 Failure to Comply or to enforce Member Compliance**

This section reinforces the Coop's obligation to comply with the various sets of requirements established in the Lease and to enforce Member compliance with those requirements of the Lease that apply to Members.

### **10.5 When CLT May Directly Enforce Member Compliance**

Whenever possible, CLTs will want to avoid intervening in the Coop's internal affairs in the way permitted by this section, but they are likely to want the power to do so when it is absolutely necessary. Most will want to set the minimum amount of prior notice required at a relatively short period or time, but in practice may prefer to wait a longer time if the situation does not involve an emergency.

### **10.6 Notice to CLT Re. Share Transfers**

This notice requirement regarding share transfers enables the CLT to receive the information necessary to monitor compliance with sections 10.1 and 10.2.

### **10.7 Non-Member Subleases**

Whereas subleases in the form of Proprietary Leases with Members can be approved or denied in terms of a single set of established policies, subleases to non-members will probably need to be considered on a case-by-case basis in terms of what is generally consistent with and most supportive of the goals of the CLT and the Coop. Some CLTs, however may want to lay out a specific set of criteria for the approval or rejection of the subleasing of residential units by the Coop to non-members

The subleasing of residential units *by Members* to non-members is a subject normally addressed in the Member's proprietary lease, and is therefore not addressed here.

### **10.8 & 10.9 Submission of Coop Budgets and Financial Reports to CLT**

The submission to the CLT of budgets and quarterly financial reports enables the CLT to monitor the financial management of the Coop. Note, however, that it is only the amounts

budgeted for an operating reserve and a replacement reserve that require CLT approval. Some CLTs may want their ground lease to give them greater ability to intervene in the management of the Coop's finances. Other CLTs may want to follow the practice of Champlain Housing Trust in dealing with financial management issues through a separate contract between CLT and Coop rather than through the ground lease – in which case sections 10.8 and 10.9 might be omitted. (If a separate contract is to be used, the Lease can require the Coop to execute such a contract with the CLT.)

#### **10.10 Submission of Meeting Minutes**

Requiring the Coop to submit to the CLT the minutes of board and membership meetings is a relatively unobtrusive way of monitoring the Coop's actions. If a CLT wants not only to be able to monitor action taken in meetings but to have the opportunity to influence such action, then it may wish to provide specifically for CLT representation in the meetings.

#### **10.11 CLT Approval of Management Contracts**

For cooperatives that can and do contract with a property manager, it is reasonable for a CLT to monitor such arrangements, and therefore to approve such contracts.

### **ARTICLE 11: Default**

All sections of this article closely follow the parallel sections of the single-family model.

#### **Section 11.1 Monetary Default by Coop**

This section requires that any notice of a Lease violation that is sent to the Coop must also be sent to any Permitted Mortgagee(s). A Permitted Mortgagee's right to receive such notice is stated in section B-6 of Exhibit PERMITTED MORTGAGES. A Permitted Mortgagee's right to cure a default is stated in Section B-1 of that exhibit, as well as in this section 11.1

#### **Section 11.2 Non-Monetary Default by Coop**

Considerations involving protection for both Coop and CLT are approximately the same for non-monetary violations as for monetary violations; however, this section provides for a longer cure period in the case of non-monetary violations, since violations of non-monetary provisions may be more complicated and time-consuming to correct.

As discussed in "Chapter 20, "Financing CLT Homes," mortgagees may have particular concerns with the possibility of non-monetary defaults, since it will normally be impossible for the mortgagee to cure such defaults. In order to address mortgagees' concerns with non-monetary defaults, some CLT single-family leases have provided for substantial fines for non-monetary violations. A failure to pay such fines becomes a monetary default, which a mortgagee has the ability to cure.

#### **11.3 Default as Result of Judicial Process**

This section would have important consequences in the event that the cooperative corporation is ever declared bankrupt. The language is intentionally broad, but a CLT should consult with its attorney regarding appropriate language for the jurisdiction in question.

#### **11.4 CLT's Remedies: Termination or Exercise of Purchase Option**

Termination of the lease and eviction of the coop and its Members is obviously a last-resort measure. Few CLTs have actually taken such action even in cases of major violations of single-family leases, but the right to do so greatly increases a CLT's ability to deal with serious lease violations. The language in this section makes it clear that, upon termination of

the lease, the CLTs right to enter and reposes the Improvements and evict the Coop and its members is subject to whatever due process is established by applicable law. No CLT should attempt to follow through with termination and eviction without the involvement of an attorney who is familiar with the law affecting that process.

The provision for exercise of the purchase option in section 12.4-b was added to the single-family model in 2010 and is based on language used by some California CLTs. Its enforceability may vary from one jurisdiction to another. Some CLTs may choose not to include it in either a single-family or coop lease. Those that do wish to include it should consult with their attorneys regarding its enforceability and potential consequences. When it can be exercised, however, it can be an easier, friendlier remedy than termination and eviction.

### **11.5 Default by CLT**

The CLT does not want to be too quickly subject to being in default if the Coop is looking for a “technicality” to which to object. On the other hand, the CLT does have certain important responsibilities under the Lease, and the Coop should not be hurt by too long a failure of the CLT to perform its obligations. The time period in this section is a suggested reasonable compromise.

## **ARTICLE 12: Mediation and Arbitration**

Prior to 2010 the single-family model lease did not provide for mediation but called for a specific arbitration process, as follows.

*ARBITRATION PROCESS: Should any grievance or dispute arise between Lessor and Lessee concerning the terms of this Lease which cannot be resolved by normal interaction, the following arbitration procedure shall be used.*

*Lessor or Lessee shall give written notice to the other of its selection of a disinterested arbitrator. Within fifteen (15) days of the receipt of this written notice, the other party may give written notice to the first party appointing a disinterested arbitrator of its own choice. These two arbitrators shall select a third arbitrator. If the other party fails to name an arbitrator within fifteen days of receiving the notice from the first party, the arbitrator selected by the first party shall be the sole arbitrator.*

*The arbitrator or arbitrators shall hold a hearing within thirty (30) days after the initial written notice by the initiator of the arbitration process. At the hearing Lessor and Lessee shall have an opportunity to present evidence and question witnesses in the presence of each other. As soon as reasonably possible, and in no event later than fifteen days after the hearing, the arbitration panel shall make a written report to the Lessor and Lessee of its findings and decisions, including a personal statement by each arbitrator of his/her decision and the reasons for it. The arbitrators shall decide the dispute or claim in accordance with the substantive law of the jurisdiction and what is just and equitable under the circumstances. The decisions and awards of the majority of the arbitration panel shall be binding and final.*

Some CLT single-family leases have prescribed mediation as a first step, but have then provided for arbitration if either party is not satisfied with the results of mediation – with the arbitration process described more or less as stated above.

It is important to note that the effect of an arbitration provision in a lease will vary from state to state. Some states (e.g., California) have very detailed statutes concerning arbitration

clauses and the effect a court must give to an arbitration award. Other states do not have such a statute, but typically judicial decisions will try to give an arbitration requirement the effect of making an attempt at arbitration a prerequisite to a lawsuit.

In the 2010 single-family model lease, the more specific arbitration *requirement* has been replaced with a broad statement of what is *permitted* (any form of mediation or arbitration that the parties agree to pursue). The reasons for the change were (1) the variations in the legal treatment of arbitration from state to state, and (2) the fact that an arbitration process can be as time-consuming and expensive as the court process it is intended to replace. This Model CLT-Coop Lease follows the approach taken in the 2010 single-family model.

Before a CLT chooses either to adopt the approach taken in this section or to adopt a more detailed, prescriptive approach, it should ask its attorney to determine how the law of the state in question deals with the arbitration process and its effects.

### **ARTICLE 13: General Provisions**

This article contains a number of provisions that do not fit elsewhere in the Lease. Other miscellaneous provisions may be added, such as those that a CLT's attorney finds necessary or useful with regard to specific features of local or state law.

#### **Section 13.1 Coop's Membership in CLT**

Some CLTs may choose to provide for CLT membership for the Coop as a corporation rather than for individual coop members. Whatever course is taken should be consistent with membership provisions in the CLT's bylaws.

#### **Section 13.2 Notices**

Notice provisions are often ignored as "boilerplate." This is unfortunate, as in many states the notice provisions of a lease are strictly interpreted by courts when one party is attempting to terminate the significant property rights of the other party. Timing is important. In an area where mail service is slow, the effective date of a notice could be made two business days after deposit in the mails, or upon actual delivery by hand, whichever is earlier.

#### **Section 13.3 Severability and Duration**

From time to time, questions have arisen as to whether particular provisions of the Lease violates the Rule Against Perpetuities. Although, as is argued in Chapter 9, "Enforceability of the CLT's Preemptive Right," the Lease should withstand such a challenge, it is prudent to protect against an adverse outcome. Therefore, this "savings" clause is designed to accomplish two goals. First, it contains standard language stating that the invalidation of one provision of the Lease does not invalidate the Lease as a whole. Secondly, it provides "measuring lives" for the purpose of determining the applicable time period under the Rule Against Perpetuities. If a court were to find some "interest" in the Lease to be subject to the Rule, that interest should at a minimum survive for the duration of the measuring lives plus 20 years (or, stretching all the way, 21 years). Given a large group of measuring lives including infants, odds are high that the interest would last the full 99 years of the Lease even in such a worst case legal situation.

Note that some states have taken the approach of the Model Rule Against Perpetuities statutes and exempted all "nondonative" transactions from the common law rule (see, e.g., Mass. Gen. Laws, Ch. 184A, Sec. 1). In those states it would be prudent to specifically refer also to the statutory exemption.

**Section 13.4 Right of First Refusal in Lieu of Option**

In the event that foreclosure of a Permitted Mortgage eliminates the CLT's option to purchase for a restricted price (see section B-7 of Exhibit PERMITTED MORTGAGES), the CLT will want an alternative means of "recapturing" the housing. This Section therefore says that if for any reason the purchase option is not available, the CLT still has a "right of first refusal." The price to the CLT in such a situation would of course be established by a third party in an open market situation. (In a foreclosure situation, the CLT may also have an opportunity to buy the Improvements back directly from the mortgagee for the amount owed the mortgagee [see section A-3 of Exhibit PERMITTED MORTGAGES]) The right of first refusal thus represents a last-resort means of regaining control of the Improvements.

This provision of a right of first refusal here in Article 13 rather than in Article 10, following the provisions relating to the purchase option eliminates any possibility of its being wiped out in a foreclosure situation along with the purchase option provisions it is intended to replace as a fall-back measure.

The specific terms of this right of first refusal (as well as the separate right of first refusal established in Section 2.3) are spelled out in Exhibit FIRST REFUSAL.

**Sections 13.5 - 13.10**

These are all standard lease clauses. Section 13.5 is intended to protect the CLT against arguments that its conduct implicitly waived rights that were otherwise explicit in the Lease. Section 13.6 deals with potential challenges to title affecting the Coop's occupancy, and obligates the Coop to give "all reasonable aid" in such actions. This is a corollary to Section 1.1, in which the Coop takes its leasehold without any representations from the CLT and without an obligation of the CLT as lessor to defend title actions. Section 13.7 makes it clear that, in the language of the Lease, no pronouns are intended to be restrictive as to gender or number. Sections 13.8 and 13.10 address different aspects of legal interpretation of the language of the Lease, stating what might be the rule anyway if the clauses were not included. And Section 13.9 in several ways points out that the Lease is a document that is intended to stand on its own and govern the CLT-Coop relationship notwithstanding discussions to the contrary and changes in the parties unless the parties go through the formality of a written amendment of the Lease. The effectiveness of such provisions will vary from jurisdiction to jurisdiction.

**Section 13.11 Recording**

In many states, the recording of a lease or some notice that the lease exists is essential for the rights of the lessee to be protected against the rights of the holder of a mortgage on the fee interest in the land. For example, Mass. Gen. Laws, Ch. 183., Sec. 4. provides that any lease for greater than 7 years must be recorded, or a notice thereof must be recorded, in the appropriate registry of deeds or the leasehold interest is subject to foreclosure by a mortgagee, even one with a mortgage recorded subsequent to the date of such unrecorded lease. There are other doctrines of actual notice which might protect a CLT ground lessee, but the safest method is to record a notice of the Lease.

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<sup>1</sup> Mass. Gen. Laws, Ch. 59, Sec. 59.

## Chapter 16

# Non-Residential Ground Leases

### Introduction

This chapter is limited to the subject of non-residential CLT ground leases – and does not address the much broader, more various and complicated subject of planning, financing and carrying out commercial or other possible economic development projects. For CLTs that are in fact planning non-residential projects, this chapter is intended to guide the drafting of appropriate lease provisions. Because such projects may involve a wide variety of situations, the chapter will not offer a model lease for any one non-residential use or purpose. Instead, it will outline some of the possible non-residential situations that a CLT may want to address, and will note the basic considerations involved in establishing lease terms for the more likely possibilities.

It should be emphasized that some of the more common non-residential uses of CLT property may *not* involve a ground lease – that is, they may not involve the kind of ownership arrangement established by a long-term land lease that provides for lessee-ownership of the improvements. Some CLT's, for instance, make facilities available to nonprofit or for-profit entities through arrangements whereby the CLT retains ownership of the improvements as well as the land and leases the whole property, perhaps on a year-to-year basis. Others make undeveloped land available for use as community gardens, either leased directly to the gardeners on a year-to-year basis or to a nonprofit organization or association that will sublease plots to gardeners. Short-term lessees such as these do not have the opportunity to build equity in the property in the way that a CLT homeowner does, but this aspect of ownership may not be important to those who simply want access to a place to carry out a certain kind of activity. Our emphasis will be on situations where a long-term ground lease does give the lessee ownership of improvements and an opportunity to build equity, but, in some of these situations, we will acknowledge that the CLT must decide whether it can better pursue its mission through such a ground lease or through a more conventional leasing of both land and improvements.

For those who do want a model for a non-residential CLT ground lease, the model residential CLT lease that appears in Chapter 11-A can be adapted. Most sections of the residential model will need only limited adaptation, as suggested in the outline at the end of the chapter. There are several articles, however, that may need to be substantially altered. In particular, we will look at the considerations involved in drafting the following articles.

- The article dealing with land use restrictions and requirements (Article 4 in the residential model).
- The article dealing with rights and responsibilities regarding lessee-owned improvements (Article 7 in the residential model).
- The article dealing with transfer restrictions (Article 10 in the residential model).

For each of these three articles, we will look at the considerations involved in drafting provisions for four basic types of land use.

- use for commercial purposes (retail stores in particular),
- use for processing raw materials or manufacturing,

- use for office facilities,
- use for agriculture.

In every one of these use categories, numerous variations are possible, potentially involving quite different purposes and therefore quite different lease arrangements. We will note some, but not all, of these possible variations.

### **Leases for Commercial Use**

CLTs may have various purposes – or combinations of purposes – in leasing land for commercial use. Possible purposes include the following.

- Creating or supporting small business opportunities for community residents.
- Creating jobs, and/or job-training opportunities for community residents.
- Making needed products or services available to community residents.
- Ensuring that certain activities will not have harmful effects on the community or the environment.
- Making use of space that is not appropriate for residential use in otherwise residential developments.

**Use restrictions and requirements.** If the primary purpose of a project is to create small business opportunities or jobs, a CLT will probably not want to establish tight use restrictions. In such cases a CLT might limit the use to retail operations, but might be open to whatever type of retail operation would bring the greatest economic benefits for local owners and/or workers, so it might not want to limit sales to particular types of products. If, on the other hand, a CLT is most concerned with the community's access to certain kinds of products (e.g., groceries), it may want to limit a lessee's retail business to those kinds of products – or at least require that it offer those products regardless of whatever else it might sell. If commercial space is located in or near residential buildings, the CLT may also be concerned with the appropriateness of the goods sold for a residential environment that will include children.

“Resident ownership” is also likely to be a concern, just as owner-occupancy is a concern with CLT residential ground leases. If the goal is to encourage local ownership of small businesses, a CLT may want to prohibit “absentee ownership” of a lessee business. But in such cases, CLTs must decide how to define the restriction. Must the owner or owners be residents of the local community? Or is the more important concern not residency as such but the question of whether an owner is a direct, day-to-day, on-site participant in the operation of the business? Or should *both* local residence and direct participation be required?

For most retail businesses, parking is likely to be a significant issue. Is there enough space for customer parking? Will trucks be able to make deliveries without disrupting local traffic? On what parts of the premises should parking be permitted? On what parts should it be prohibited? If a commercial space is located in a residential building, how will parking space be allocated between residential and commercial uses?

**Lessee-owned improvements.** CLTs must decide how much they want to limit a commercial lessee's ability to invest in permanent improvements to the premises. If the goal is to help low-income people develop their own businesses, the CLT must recognize that the ability of such entrepreneurs to finance a substantial up-front investment will itself be limited. Whereas a low-income homebuyer may be able to borrow \$100,000 or

more to buy a house, a low-income entrepreneur will have access to much less capital. (A number of community development financial institutions do finance small business startups, but the loan amounts are more likely to be \$10,000 than \$100,000.) The CLT must also recognize, first, that the failure rate for small business startups is significant and, secondly, that those that do succeed are likely to outgrow their original quarters – so a significant amount of turnover among startup lessees should be anticipated. For these reasons, a large investment in specialized improvements that may not be useful to subsequent lessees should probably be avoided. There will be an advantage in maintaining a relatively generic storefront facility that can accommodate a variety of retail businesses. In fact there may be reason to avoid lessee-ownership of permanent improvements altogether when dealing with startup businesses. Like the “business incubators” operated by some CDCs, community land trusts that are leasing space to startup commercial enterprises should probably encourage successful lessees not to stay in the “incubator” too long but to make way for others. In such situations building lessee-equity in the improvements is not likely to be a CLT’s goal.

On the other hand if you are less concerned with helping people in the community launch and own their own businesses and are more concerned with bringing investment into the community and creating jobs, you may have reason to allow – and encourage – larger investments in improvements. An existing corporation that wants to open an outlet in your community may be quite capable of buying a building and customizing it to accommodate its commercial needs, and there may be important benefits for the community in having it do so.

With any commercial leasehold, it will be especially important for the lease to distinguish clearly between permanent improvements (owned by the lessee but subject to lease restrictions) and business equipment owned by the lessee and not subject to lease restrictions. (See Chapter 10, “Legal Issues Re. CLT Ownership” for a discussion of what are generally considered permanent improvements, as opposed to “personal property.”)

**Transfer restrictions.** Transfer restrictions normally address two issues – the question of *whom* improvements and leasehold interest can be transferred to, and the question of the *price* that the seller will be allowed to charge for the improvements and leasehold interest in the land. On the first question, if a CLT is more concerned with local ownership of local businesses than with jobs as such, it may want to allow transfer only to existing residents of the community, although the question of where the transferee is *from* may be less important than whether she will *now* be a permanent resident of the community and whether she will be directly involved in the operation of the business. If, however, the emphasis is on encouraging investment in the community and creating jobs, the CLT will not want the terms of the lease to screen out potential investors from outside the community.

Regarding price restrictions, it is a relatively simple matter to design a resale formula that will allow a commercial lessee to recover the price she initially paid for the improvements, perhaps adjusted for depreciation, and perhaps with an adjustment recognizing inflation, based on either a fixed rate of “interest” or on changes in an index such as the consumer price index. In this respect, designing a resale formula for a commercial property is similar to designing a resale formula for CLT homeownership situations (see Chapter 12, “Resale Formula Design”).

However, commercial lessees are much more likely than residential lessees to need to invest in further improvements to accommodate the evolution and/or expansion of their businesses. It is not a simple matter to decide how much equity the commercial lessee should be allowed to build up through such further investment, or to decide how this equity build-up should be measured. If the CLT wants to encourage ownership of local businesses by local residents, it will need to strike a balance between, on the one hand, establishing a strict limit on equity build-up so that the property will remain affordable for successive lessees, and, on the other hand, allowing prices to increase by amounts reflecting the actual use value that the lessee has added. If the property in question is seen primarily as an “incubator” for small businesses, the CLT will probably lean toward allowing little or no equity build-up in the improvements, but if the goal is to encourage long-term investment in the improvements – as a means of “asset-building” for the lessee, and/or as a means of encouraging the kind of investment that will bring jobs and shopping opportunities to the community – the CLT may lean toward a policy that will allow the resale price to be substantially increased by the lessee’s further investment in improvements.

In the latter case, the question is how to determine the amount of the increase without the process becoming unduly burdensome for both the CLT and the lessee. If the investment is in one or a few substantial bodies of work, each of which has a documented cost and appraisable value, the matter may be treated in the way that major capital improvements are treated in some residential resale formulas (again see Chapter 12). However, if the investment is in a number of smaller improvements scattered over a number of years, and if much of the labor has been provided by the owner, a formula that does not try to itemize the value of each improvement may be preferable. The better approach may be an appraisal-based appreciation-sharing formula that allocates to the lessee some percentage of the increase in overall market value as determined by appraisals at the time of purchase and the time of resale.

It is also possible, of course, not to impose any price restriction and to let the price be determined by the market for the type of improvements in question. That market would itself be limited by the use restrictions established in the lease – which may prohibit what would otherwise be the most profitable use and may therefore reduce the market price.

### **Leases for Processing or Manufacturing Use**

Processing or manufacturing uses can range from activities like cheese-making, among other types of food-processing, to the repair of watches or shoes or automobiles, to the manufacture of better mousetraps or widgets. A CLT’s reasons for leasing land for these uses will cover more or less the same range of possibilities as the possible reasons for leasing to commercial businesses. In fact, processing and retail sales are often combined in small businesses such as restaurants, bakeries and other small food processing enterprises.

**Use restrictions and requirements.** Lease provisions relating to processing or manufacturing are likely to be more specific than those relating to most retail businesses. A CLT will usually *not* want its lease to specify exactly what products are to be sold in a storefront property, but, in the case of a manufacturing facility, the CLT probably *will* want the lease to state rather specifically what is and is not to be produced on the premises. In entering into such a lease for a specific manufacturing process, the CLT

may be influenced by what products are needed in the community, by what is likely to contribute to the success of the lessee's business, by the potential for job creation, and by the potential effects of the process on the environment (ranging from the effects on local water or air quality, to noise levels, to the "carbon footprint" and its effect on global climate), as well as by the appropriateness of the location and the facility for the process in question.

Permission to carry out the specified processes on the premises should of course be conditioned upon the lessee acquiring any government permits that may be required for the activity and upon compliance with any statutes or codes regulating the activity. And of course appropriate liability insurance covering the activity should be required.

**Lessee-owned improvements.** Because processing and manufacturing activities are more likely than commercial activities to require specialized improvements, a lease that allows these activities will need to allow the lessee to construct or install any such necessary improvements not already present. A CLT entering into such a lease will be concerned about whether these improvements will commit the facility *permanently* to the one process for which they are installed, and, if so, whether the process can be expected to be both economically viable and appropriate for the community for the long term. In either case – regardless of how tightly the lease restricts future use of the property – the CLT will want to retain the right to pre-approve (or reject) any major alterations or additions to the improvements, so that it can be sure that that the changes are appropriate for the intended use and that they will not interfere with the future affordability or practicality of the property and will not have a harmful effect on the surrounding community.

**Transfer restrictions.** Since it is likely that a lessee engaged in this kind of business will have made substantial investments in specialized improvements, the CLT will need to give careful attention to the question of how much of this investment she should be able to recover when she sells. Before addressing this question, however, the CLT must decide whether the lease will commit the property to its current use by permitting transfer only to a person or entity that will carry on more or less the same type of business and will therefore make use of the specialized improvements. For instance, if the property is used by a bakery that has installed commercial ovens, can it then be transferred only to another bakery business? If transfer is to be restricted in this way, then it may be appropriate to adopt a resale formula that will allow the seller to recover a substantial part of the value invested in specialized improvements that will now be used by a successor. If such improvements consist of equipment that is purchased and installed at the beginning of (or early in) the term of the lease, then a resale formula may simply allow recovery of the documented original cost of those improvements less depreciation at a stipulated rate. If, on the other hand, the investment consists of a number of smaller improvements scattered over a number of years, then the type of "appraisal-based" formula suggested above for similar situations with commercial businesses may be the better choice.

If transfer is not restricted to buyers who will carry on the type of business currently operated in the facility – or perhaps even if it is so restricted – the CLT may prefer to treat specialized improvements, such as a baker's commercial ovens, as personal property of the lessee, which will mean that the lessee can either remove them when vacating the premises or can sell them in place for whatever price the market will bear. In the latter

case, even if the buyer is also the new ground lessee, the sale of this specialized, “personal property” will be separate from the sale of the “permanent improvements” (the building and other permanent structures) and will not be subject to the CLT’s purchase option. (Again, see Chapter 10, “Legal Issues Re. CLT Ownership,” for a discussion of what are generally considered permanent improvements as opposed to “personal property.”)

### **Leases for Office Use**

Some CLTs lease real estate to other nonprofit organizations for use as office space and related functions, including meetings with customers, clients, patients, trainees, etc. It has been less common for CLTs to lease property to for-profit entities for similar uses, but there may be situations where a CLT has reason to do so, and most of the issues involved are not likely to differ from those that must be addressed in leasing to nonprofits. We should also note that, although CLTs sometimes make office space available through relatively conventional shorter-term leases that do not provide for lessee ownership of improvements, we will concentrate here on the use of long-term ground leases for office space.

The CLT purposes that may be served by such lease arrangements include the following.

- Assisting other not-for-profit organizations by making space available on affordable terms.
- Providing affordable space for entrepreneurial ventures by low-income people, women and minorities within the community.
- Providing appropriate space for training, counseling, medical treatment, or other services that will benefit residents of the community.
- Generating revenue for the CLT.

**Use restrictions and requirements.** The nature of use requirements or restrictions will depend on the CLT’s purpose in acquiring and/or developing the facility and on the extent to which the facility and its location are suited for one or another specialized use, as well as on the CLT’s concern with generating a certain level of revenue. If the CLT’s purpose is to assist in supporting other nonprofit programs in the community, the use of the facility may be restricted to nonprofit programs, or perhaps to specific *types* of nonprofit programs. If the facility has been developed specifically to facilitate certain services in the community, its use may be restricted to providers of those services, whether nonprofit or for-profit. If the CLT’s operating budget for the facility calls for a significant level of lease fee revenue, and if the facility contains generic office space – suitable for any individual, program or business that needs space in which to locate one or more desks, telephones, computers, etc. – then the CLT may choose to establish only minimal use restrictions. Even in such cases, however, the lease may still require that the lessee make actual use of the space on an ongoing day-to-day basis.

The CLT lease should of course prohibit any use that violates applicable law. And, in any case, the CLT should be mindful of possible specific uses that may be legal but that should not be permitted under the terms of the lease. For instance the cooking of food might be prohibited if appropriate kitchen facilities are not provided. Subleasing – unless the lease explicitly anticipates and accommodates some form of subleasing, as discussed

below – should generally be prohibited or be permitted only with the CLT’s written consent.

**Lessee-owned improvements.** If a lessee will use an entire building for its offices, then it is appropriate for the lessee to own the building. It may also be appropriate for the lessee to own the building if the lessee will use only a part of the space but is prepared to own, sublease and manage other parts in accordance with the terms of the lease. The terms of the lease may limit the amount of profit that the lessee can realize through such an arrangement but should allow the lessee to recover the costs of managing, as well as owning, the subleased space (see Section 4.5 of the model single family residential lease for language that may be adapted). The alternative to this sort of arrangement is of course for the CLT to retain ownership of the building and lease space directly to multiple tenants.

A lease for office space should normally place strict limits on the lessee’s right to alter or improve lessee-owned improvements without the CLT’s written permission (but should require maintenance of existing improvements). When there is a need for specific alterations or improvements, the CLT will want to work with the lessee to develop appropriate plans for work to be done by or paid for by the lessee-owner.

**Transfer restrictions.** As is the case with other types of non-residential leases, restrictions regarding who is an eligible transferee will depend on what use restrictions are established. For office space that is not limited to use supporting the provision of specified benefits or services for the community, there may be few explicit limitations on who the improvements can be sold to, though the CLT will probably still want the right to approve or reject proposed transferees. As is true with leases for commercial or manufacturing facilities, if an office facility has been subsidized for the stated purpose of assisting specified disadvantaged or underserved groups such as low-income people, women, or minorities), then it may be necessary, or at least appropriate, to permit transfer only to members of these groups.

CLTs will generally not want to allow substantial alterations or improvements to “generic” office space that would increase the resale price of the improvements. Nonetheless, there are likely to be instances when such changes are in the interest of the CLT and the community and the CLT may therefore allow a “capital improvement credit” to be added to the resale price.

## **Leases for Agricultural Use**

A CLT’s purposes in leasing land for agricultural use may include the following.

- Providing affordable access to land for new farmers.
- Providing access to fresh, locally produced food for local residents.
- Promoting ecologically sound use of local land.
- Protecting open space and preserving a “working landscape” that is seen as an essential part of the community’s identity.

A detailed treatment of the use of ground leases to serve these purposes is provided by Equity Trust, Inc. Equity Trust’s publication *Preserving Farms for Farmers: A Manual for Those Working to Keep Farms Affordable*, which includes case studies, a model agricultural ground lease with commentary, and related materials, can be ordered from the organization’s website ([www.equitytrust.org](http://www.equitytrust.org)). The model agricultural lease, which is a modified version of ICE’s 2002 Model CLT Ground Lease (to which Equity

Trust holds the copyright) is separately posted on the website. Commentary on that model is also posted. Because these materials are readily available from Equity Trust, we will offer only a general overview of the subject of agricultural ground leases in this chapter. And we will not discuss the many varieties of more conventional farm lease arrangements that involve shorter terms and do not provide for lessee-ownership of improvements.

**Use restrictions and requirements.** Agricultural ground leases of the sort pioneered by Equity Trust not only permit but *require* a specified level of agricultural use of the land – a provision paralleling the occupancy requirement of CLT residential leases. In addition such leases may establish specific provisions regarding the *type* of agricultural use permitted or required. In some cases, organic farming (by one or another definition) is required. Specific provisions may also be established regarding the different uses of different *parts* of the leased land – in some cases through the attachment of an approved (but potentially amendable) “farm plan” with a map distinguishing tillable areas, areas to be used for grazing, protected riparian areas, forest management areas, etc. There can also be special provisions for a “farmstead” area containing farm buildings and other agricultural improvements – and often residential improvements as well. When a farmhouse is included, there is usually an occupancy requirement similar to that in CLT residential leases.

**Lessee-owned improvements.** Agricultural improvements that may be owned by a ground lessee include a wide range of items not typically addressed in residential ground leases. These include not only such things as barns, fences and irrigation systems but, in some cases, perennial plantings such as orchards – all of which clearly add lasting value to the land for agricultural use. Development of non-agricultural improvements is usually prohibited or strictly limited, though processing and marketing facilities (e.g., milk-processing/cheese-making facilities, grain milling facilities, farm stands, etc.) may be permitted. Construction of new buildings, even for agricultural purposes, is typically permitted only within specified “building envelopes.” As with CLT residential leases, approval by the ground lessor is typically required for construction of any new buildings, and, in reviewing requests for approval, the lessor is usually directed to consider the future affordability of the improvements for farmers, among other factors.

**Transfer restrictions.** Transfer is normally permitted only to people approved by the lessor as having demonstrated the intention and the ability to use the property for “commercial” agricultural purposes (the exclusion of “hobby farmers” is intended). Resale price restrictions are designed to keep resale prices affordable for people dependent on farming for their living (admittedly a less precise criterion than the income-based definition of affordability used in affordable housing programs). The resale formulas that may be used include some that are familiar to CLTs, but the most common practice is to define the purchase option price as the *appraised agricultural value* of the improvements. Such appraisals usually employ both the market comparison approach (comparing the property to other farms in the area that have been sold for known prices to buyers intending to use them for agricultural purposes) and the income approach (calculating the present value of the net income that can be generated by use of the property for agriculture). These leases are typically used in real estate markets where the “estate value” of farms, created by demand from affluent non-farmers, far out-strips their

agricultural value. In these situations the appraised *unrestricted* market value can easily be more than twice the appraised as-restricted agricultural value.

### **Lease Fees and Revenue Generation**

In establishing the fees to be charged to non-residential lessees, CLTs will be concerned with balancing the interests of the lessee and the social goals of the arrangement on the one hand, and, on the other hand, the CLT's interest in generating enough revenue to cover the costs of stewardship and perhaps to help service debt arising from the acquisition and/or development of the property. The need for finding such a balance should be addressed in the early stages of planning for the project. If in fact the lease fee cannot be subsidized – or can be subsidized only to a limited extent – then certain purposes, such as helping low-income people start their own businesses, may not be practical.

In most of the situations discussed above, a CLT will want to subsidize lease fees as much as possible – at least during the start-up phase of small businesses, when cash flows can be expected to be lean. In these situations a graduated fee scale – beginning with a very low fee and increasing over time – may make sense. If the lessee is an established business, however, the situation may call for a market-rate fee – both because it will provide more revenue for the CLT and because, for a 501(c)(3) organization, subsidized rent is generally prohibited for a for-profit business if the subsidy does not serve a charitable purpose (such as helping a low-income person start a business). It should be understood, however, that the restrictions and requirements established by a lease can substantially reduce the market value of the leasehold – as in the case of the agricultural leases noted above. This being the case, the lease should provide (as the model residential lease does in section 5.6) for the adjustment of the fee if and when restrictions are eliminated or reduced.

### **Adapting the Model Residential Ground Lease: an Overview**

Though certain modifications will be necessary, the model CLT single-family residential ground lease (Chapter 11-A) can provide a practical framework within which to develop leases for non-residential purposes. In most cases, the majority of the articles in the model residential lease can be utilized in a non-residential lease with little or no modification, as indicated in the following outline (articles are numbered as in the single-family residential lease). The Commentary on the model residential lease (Chapter 11-B) may be helpful in working out adaptations.

1. *Letters of Agreement and Attorney's Acknowledgement.* When the lessee is a corporation rather than one or more individuals, the CLT may omit this requirement (as in the CLT-coop lease presented in Chapter 15).
2. *Leasing of Rights to Land.* This article is applicable for non-residential use.
3. *Term of Lease; Change of Land Owner.* This article is applicable for non-residential use.
4. *Use of Leased Land.* Some sections of this article may be adapted for non-residential use, but specific provisions for non-residential use will need to be drafted, as discussed in this chapter.
5. *Lease Fee.* Most sections are applicable for non-residential use, but different considerations are likely to be involved in determining the amount of the fee, as discussed in this chapter.

6. *Taxes and Assessments.* This article is applicable for non-residential use.
7. *The Improvements.* Some sections of this article may be adapted for non-residential use, but additional provisions may be needed, as discussed in this chapter.
8. *Financing.* Most if not all of the provisions in the residential lease are applicable.
9. *Liability, Insurance, Damage and Destruction, Eminent Domain.* This article is applicable for non-residential use, though specifications for liability insurance may need to be modified.
10. *Transfer of the Improvements.* Some sections may be adapted for non-residential use, but additional considerations are likely, as discussed in this chapter.
11. *Reserved.* Identified as “reserved” in the current version of the residential model, this article can be used to deal with any additional subjects a non-residential lease may need to address.
12. *Default.* This article is applicable for non-residential use.
13. *Mediation and Arbitration.* This article is applicable for non-residential use.
14. *General Provisions.* This article is applicable for non-residential use.

## Chapter 17

# Property Tax Assessments

Property tax assessments are a major factor in determining the affordability of CLT homes. When the assessed value of CLT homes increases, the taxes will of course increase, which will in turn increase the amount that must be added to the homeowner's monthly mortgage payment to be escrowed for taxes, thereby decreasing what is available for repayment of mortgage debt. For lower income households a higher assessment can easily wipe out the affordability of a given CLT home – or require a substantially larger subsidy to make that home affordable. The subject of tax assessment is therefore extremely important for CLTs. Unfortunately it is a subject that is treated differently in different states, and that in most states is treated differently from one local jurisdiction to another. In many states, treatment is also subject to change – or is in the process of changing – as it is addressed by the courts or state agencies, or, in some cases, by pending legislation.

Because of this variety and ongoing change, this chapter does not attempt a comprehensive review of exactly what CLTs around the country will face when they sit down to talk with their local tax assessors about the assessment of CLT homes. Instead, the goals of the chapter are, first, to frame the basic issues involved in determining how CLT homes (or other owner-occupied, resale-restricted homes) should, ideally, be assessed, then to describe in general terms the different approaches to assessment of CLT property currently being taken in different jurisdictions, and finally to review some legislation recently passed in several states and to consider the issues that concern those advocating for such legislation in other states.

### Theoretical Overview

**Premises.** Although many aspects of this subject vary from one jurisdiction to another, there are some basic assumptions and circumstances that are constant for all CLTs in all jurisdictions.

*CLT homes should be taxed.* CLT's do not seek exemption from property taxes for their homeowners. It is agreed that residents of CLT homes consume local government services (schools, streets, sidewalks, police and fire protection, etc.) to the same extent that other residents of the community do. Property taxes may not be the best form of taxation for funding these services, but, for so long as it is the system that *is* used, there is wide agreement that CLT homes should not be exempt from the basic obligations imposed by the system.

*CLT Leases require homeowners to pay all property taxes.* Virtually all CLT leases pass on the cost of all property taxes to the lessee-homeowner. Some do this by assigning responsibility for payment of taxes on both the home and the leased land directly to the homeowner (as in Section 6.1 of the Model Lease). Others assign responsibility for payment of taxes on the home (improvements only) directly to the homeowner, while assigning responsibility for taxes on the land to the CLT but then adding the amount of this tax to the lease fee that the homeowner must pay to the CLT. In either case the full cost of property taxes is added to the homeowner's monthly housing costs.

*Taxes are based on market value of property.* All U.S. property tax systems base the amount of taxes due for a particular piece of property on an assessment of the value of that property. In many jurisdictions the “assessed value” is required by law to equal a reasonable estimation of the full amount of the property’s market value. In other jurisdictions assessed value may be required by law to equal a lesser percentage of full market value, with that percentage being the same for all property in the jurisdiction. The underlying assumption in any case is that no property owner in the jurisdiction should be taxed on a higher percentage of the market value of her property than any other property owner in the jurisdiction.

**Theoretical basis for assessing CLT and other shared equity property.** The question then is how should the market value of CLT property be defined. Virtually everyone involved with any form of “shared equity homeownership” will agree that the market value of shared equity property should not be measured in the same way as the value of unrestricted property. All shared-equity property is burdened by restrictions that undeniably limit what the owner can sell it for in the market place. The situation for CLTs, however, is somewhat more complicated than for other forms of shared equity property, such as deed-restricted homes. Unlike deed restricted ownership, CLT ownership is divided into a “leasehold interest” held by the lessee-homeowner and a “leased fee” interest held by the CLT. Both of these ownership interests are burdened by restrictions – but not the same restrictions.

*Determining the value of a CLT homeowner’s leasehold interest* (or the value of a deed-restricted home). Restrictions on the price for which a CLT homeowner can sell her home (including both the improvements and the leasehold interest in the land) are an essential feature of CLT ground leases. These price restrictions, together with restrictions on the rent that the owner can receive from sublessees (if subleasing is permitted at all), permanently limit the financial return yielded by this form of ownership, usually to a level substantially below the return that the market would yield in the absence of these restrictions. CLTs and their homeowners have consistently taken the position that to assess the value of such an ownership interest as if its market value were not affected by the restrictions is to violate the principle that all property within a tax jurisdiction should be assessed for the same percentage of true market value.

Most CLTs have argued specifically that, for tax purposes, the market value of the homeowner’s property should be defined as equal to the CLT’s purchase option price (the maximum permitted resale price) at the time of tax assessment. At the time of the *initial* assessment, the purchase option price, under almost all resale formulas, is the “base price” for which the home is being purchased (the possible exception being the rarely used “mortgage-based formula”). This base price will normally be roughly equal to the unrestricted value of the home minus the amount of subsidy in the home, which can be as much as \$50,000 or more. At the time of later reassessments, the purchase option price will be defined by the particular resale formula contained in the lease. In an appreciating market, these formulas will generally increase the effect of the original subsidy, so that, for instance, a home with an original subsidy of \$50,000 might have a “formula price” some years later that is \$100,000 less than what the home’s unrestricted value would be.

*Assessing the value of the CLT’s leased fee.* The market value of the CLT’s ownership interest in the land (the “leased fee”) is limited in two ways. It is limited first by the fact that the monthly lease fee received by the CLT is reduced for the sake of

affordability to an amount that is typically much less than a market-rate ground rent would be. It is further limited by the fact that the CLT's future ability either to increase the rent to a market rate or to convert the property in any way to a more profitable use is strictly limited by the very long term and renewability of the lease. The conventional method of appraising the market value of a leased fee is to calculate the present value of the stream of rental income and to add to this amount the present value of what the property will be worth upon the expiration of the lease. In the case of a 99-year renewable CLT lease it is usually assumed that the value remaining upon expiration is so remote in time that its present value is insignificant, so the market value of the leased fee can be seen simply as the present value of a stream of less-than-market-rate ground rent payments over a term approximating that of a very long term loan (30 years or longer). The result will vary depending on the capitalization rate used in calculating present value, but typically it will be an amount much less than what the land could be sold for if it were not encumbered by a CLT lease.

### **Overview of Current Real-World Practices**

Having reviewed what most CLTs would agree is the way CLT property *ought* to be tax-assessed, we will now look at the variety of approaches actually being taken by tax jurisdictions across the country.

**State-by-state variations.** Tax assessments are carried out locally (municipality-by-municipality or county-by-county) but states differ in the way in which, and the extent to which, they advise or regulate the practices of local jurisdictions regarding the assessment of shared equity property.

A few states have adopted legislation requiring that such property be assessed at a lower value than unrestricted property. This legislation may be specific to community land trust property (like legislation recently enacted in Florida and North Carolina) or it may be written more broadly to apply to property committed to other forms of shared equity homeownership (as in Vermont). Elsewhere, local practice may be guided not by legislation but by case law established through courts within the state. In some states, court decisions (e.g., the often-cited Prowitz decision in New Jersey) have clearly supported reduced assessments for shared-equity homes. In other states (e.g., New York) courts have not found a clear legal basis for reduced assessments.

In many states, local tax assessment practices are guided to a greater or lesser extent by variously named state agencies (e.g. California's Tax Equalization Board, or New York's Office of Real Property Services). These agencies interpret the applicable law (legislation and/or case law) and assist local assessors in complying with it. They may or may not have specific enforcement powers. It must be said, however, that in a majority of states actual practice varies significantly from one local jurisdiction to another.

**Tests commonly applied.** In all cases, one or another party – whether a state legislature, a state court, a state agency, or a local assessor – must decide whether a given set of restrictions on a property owner's rights constitutes grounds for a reduced assessment. These decisions have generally rested on a series of “tests” – the most common of which are the following.

- *Limited return.* The restrictions must clearly limit the financial return that the owner can receive from the sale or rental of the property. CLT ground leases do limit financial return in these ways.

- *Long duration.* The restrictions should not be of such short duration that the owner can look forward to a time when she can achieve an unrestricted return on her investment. The restrictions on a CLT homeowner's return will never expire. Restrictions on the return generated by CLT's leased fee interest can increase only if and when the amount of the lease fee is increased.
- *Irrevocability.* The restrictions must not be revocable. The CLT lease does not permit the restrictions on the homeowner's rights to be revoked (though the resale restrictions on the leasehold interest can be removed pursuant to a mortgage foreclosure). Restrictions on the value of the leased fee can be eliminated or modified only if the CLT exercises its purchase option and then alters the terms on which it re-leases or sells the property – in which case its actions are still generally limited by its charitable purposes and 501(c)(3) status.
- *Disclosure.* The nature of the restrictions must of course be disclosed to the owners – as is established CLT practice, reinforced and documented by a “letter of agreement” and a “letter of and attorney's acknowledgement.”
- *Recording.* The documents establishing the restrictions must be a matter of public record. CLTs normally record a memorandum of ground lease (or deed covenant) for each CLT home.
- *Public benefit.* The restrictions must provide benefits to the public – as is the case with CLT programs that not only create affordable homeownership opportunities for certain individuals but preserve those opportunities for future members of the community.

**Common methods of assessing the restricted value of CLT property.** When it is decided that the assessed value of CLT property should be based on something less than its unrestricted market value, differing methods have been employed in different jurisdictions to determine how much the assessment should be reduced.

The simplest method is to reduce the assessed value of all CLT properties (including both the homeowner's property and the CLT's leased fee) by a set percentage of the presumed unrestricted market value of the whole. This approach is easy for the assessor to apply but arbitrary in its application to individual homes that are subsidized to substantially different degrees. The rest of the approaches identified below involve separate assessment of the homeowner's and CLT's property.

*Methods of adjusting assessed value of homeowner's property*

1. The assessor may assess the restricted value of the homeowner's property by reducing that property's unrestricted value by a set percentage. This method is almost as easy and equally as arbitrary as when a set percentage is applied to the combined value of home and land, as described above.
2. The assessor may initially assess the value of the homeowner's property as equal to the amount of the base price (subsidized price) paid by the homeowner, with later reassessments then determined by adjusting the base price upward (or conceivably downward) by the average rate of change in assessed value for unrestricted property in the jurisdiction. This approach is less arbitrary than #1 above, but, in an appreciating market, it is likely to result in assessed value increasing more rapidly over time than the resale price would increase under most resale formulas.

3. The assessor may assess the value of the homeowner's property as equal to the maximum amount for which it could be sold (the purchase option price) at the time of the assessment. As noted above, under almost all resale formulas this method will result in an initial assessed value that is the same as the base price paid by the homeowner (as with #2 above); however, subsequent reassessments will increase only as fast as the purchase option price increases rather than at the rate that market prices increase. The ease of this method of adjusting value over time will depend somewhat on the type of resale formula used. With fixed-rate and indexed formulas the process involves only the application of a single annual percentage rate. With appraisal-based formulas it is relatively simple to calculate the owner's share of whatever increase in unrestricted market value the assessor assigns to the property. However, a more serious complication arises with any of these formulas if they provide for the inclusion of a "capital improvement factor" in the calculation of the resale price. With such formulas, the assessor will need to know, for each home, whether a capital improvement factor has in fact been approved, and, if so, for what dollar amount. In this situation, assessors will presumably be more inclined to fall back on the practice of limiting the increase in value of all homes to the same percentage.

*Methods of adjusting assessed value of the land (CLT's leased fee)*

1. The assessor may adjust only the assessed value of the homeowner's property while assessing the land at the value it would have if it were not "burdened" by the ground lease.
2. The assessor may treat the land as fully exempt from property taxes because it is owned by a 501(c)(3) charitable organization.
3. The assessor may adjust the value of the land downward by a set percentage, in recognition of the fact that it is burdened by a long-term lease with a below-market-rate lease fee.
4. The assessor may determine the value of the land in the way described in the "theoretical overview" above – by calculating the present value of the long-term stream of lease fee revenue.

### **Issues in Drafting Legislation**

Many of the inconsistencies and difficulties of the present situation can be resolved in the long run through state-by-state legislation that clearly dictates appropriate reductions in the assessments of all shared equity homes within the state. Though the readiness of state legislatures to address this issue will vary considerably, the fact that several state legislatures have recently done so should encourage CLTs and other shared equity programs in other states to advocate for legislative solutions.

Such legislation will normally be developed in the context of – and will be affected by – existing state law relating to affordable housing and to property tax assessment, so the language in which statutes are drafted can be expected to differ from state to state. But, whatever the context, anyone interested in promoting such legislation will want to think carefully about how a proposed bill will define certain key factors. We will discuss the most important of these factors below, and will note the different ways they have been defined in specific bills passed in Vermont, Florida, and North Carolina – the pertinent portions of which are attached at the end of this chapter. (We focus on

legislation from these states to illustrate varying approaches – not to offer specific legal advice to CLTs in those states, which should seek such advice from their own attorneys, who will be more fully informed regarding the applicable laws and local practices.)

**Definition of qualifying sponsoring entity.** What sort of entity must establish and enforce the restrictions if the restrictions are to be grounds for reduced tax assessments? Several states, including Florida and North Carolina, have passed legislation providing reduced assessments specifically for property restricted by CLTs (or at least for property restricted through methods commonly used by CLTs), but not for property restricted and stewarded by other types of entities using other methods. The Vermont legislation, on the other hand, is framed in much broader terms – applying to “non-rental residential property” that is subject to a “housing subsidy covenant,” which, as defined elsewhere in Vermont law, can be established by a variety of not-for-profit and governmental entities.

CLT advocates who are seeking tax assessment legislation may see an advantage in a CLT-specific bill, since it is immediately clear that such a bill applies to CLT property, with no need to explain to assessors how and why it applies. In terms of long-term CLT strategy, however, there is likely to be more benefit from a more broadly defined bill. For one thing, the chances of getting such a bill passed – at least in some states – can be increased by joining forces with other types of shared equity homeownership programs. For another thing, there is a risk that the legislative process may result in CLT-specific bills with terms so *narrowly* specific that even some CLT programs will not qualify for reduced tax assessments. The state of Texas, for instance, adopted legislation providing for reduced property taxes for CLT programs, but the legislation defines CLT programs as necessarily serving a lower range of household incomes than the majority of CLT programs (at least in other states) do serve.

**Definition of qualifying ownership interest.** The North Carolina legislation applies *both* to restricted long-term (at least 99 year) leasehold interests (which may or may not include deeded ownership of the improvements) *and* to fee interests that are restricted by deed covenants. For CLTs that establish restrictions on condominium units through deed covenants, it is obviously important that the legislation apply to this form of restricted ownership. The North Carolina legislation does *not* address the assessment of the CLT’s leased fee interest in the land.

The Florida legislation provides specifically for CLT leasehold interests but does not appear to cover deed-restricted ownership interests (whether established by CLTs or other not-for-profit or government entities). However it does specifically cover the CLT’s leased fee interest in the land (providing for full exemption from taxes for this property).

The Vermont legislation can apply to any fee interest that is restricted by a “housing subsidy covenant” (a term which one might assume would be limited to property in which a *government* subsidy had been invested, but which is defined elsewhere in Vermont law [27 V.S.A. § 610] in terms that do *not* specify a government source for the subsidy). There is no mention of ground leases, leasehold interests, or leased fee interests in the Vermont legislation. It should be noted, however, that housing subsidy covenants are routinely filed in Vermont, as separate documents, against a CLT homeowner’s property, regardless of whether the homeowner holds a leasehold interest or a fee interest in the land.

**Definitions of qualifying restriction and qualifying owner.** The Florida legislation relates only to restrictions established through a ground lease. The ground lease must have a term of 99 years, and must give the CLT “a preemptive option to purchase any structural improvements on the land at a price determined by a formula that is designed to ensure that the improvements remain affordable” for households within income limits, specified elsewhere in Florida law, ranging up to 120% of AMI. No CLT should have a problem with these provisions as long as it uses a 99-year ground lease with a resale formula designed to preserve affordability for a mix of incomes not exceeding 120% of AMI. But shared equity homeownership restrictions established through deed covenants (or other legal means) are not covered.

The North Carolina legislation defines qualifying restrictions as lasting for “at least 99 years,” but differs from the Florida legislation in its treatment of income requirements. It does not specify the income levels for which the restriction is intended to preserve affordability (as Florida law does), but it defines “qualified owner” as one whose household income at time of transfer (i.e., purchase) does not exceed 100% of AMI. This legislation would create no problems for CLTs that do not sell homes to buyers with household incomes greater than 100% of AMI, but would create a significant problem for those intending to serve households with incomes up to 120% of AMI.

In Vermont, the definition of a qualifying restriction hinges on the broad meaning of the term “housing subsidy covenant,” as defined elsewhere in Vermont law (27 V.S.A. § 610), in part as follows: “A housing subsidy covenant may include without limitation restrictions on the use of real property, restrictions on resale price, restrictions on tenant income and rents and restrictions on the income of a purchaser of housing or a housing unit for his or her own residence.” This section of the law also states that the duration of such covenants “may be perpetual or may be limited to a period of time specified in the document.”

**Method of adjusting assessment.** Regarding the assessment of the CLT lessee’s property (both initially and in succeeding assessments), the Florida legislation states, “The amount a willing purchaser would pay a willing seller [thus the assessed value] shall be limited to the restricted price at which the improvement may be sold.”

Regarding the assessment of the CLT’s leased fee, this legislation provides for full tax exemption as long as the CLT qualifies as a 501(c)(3) charitable organization.

The North Carolina legislation states that the initial assessed value is to be “the initial investment basis” (i.e., the “base price” paid by the homeowner). For successive reappraisals, assessed value is to be “the maximum sales price permitted pursuant to the resale restrictions effective for a hypothetical sale occurring on the date of reappraisal.” This legislation also deals specifically with a factor that can otherwise cause confusion. It states that any subsidy provided in the form of a deferred loan to the homeowner (“silent mortgage amount”) is to be subtracted in determining the resale price, and thus in determining the assessed value.

The Vermont legislation does not specify a method for adjusting the assessed value of property that is subject to a housing subsidy covenant. It simply states that such covenants are among the factors to be taken into consideration in determining assessed value. In fact, although it clearly *permits* a reduction in the assessed value of shared equity homes, this legislation stops short of mandating that the assessed value of such homes *shall* be reduced. The Vermont Department of Taxation has issued a

memorandum outlining in some detail a “uniform approach... for determining the listed value of owner-occupied homes subject to resale restrictions.” The memorandum is not binding on local tax jurisdictions, the majority of which are small rural towns where assessments are done by volunteer listers. As a result, actual practice is still not uniform from town to town.

### **Basic Features of “Best” Legislation**

Although the appropriate forms for shared equity tax assessment legislation will differ from state to state, it is possible to identify basic features of such legislation that will best suit the purposes of community land trusts and other shared equity homeownership programs.

- The legislation should have the breadth of the Vermont legislation with regard to the type of entity that can establish restrictions that will reduce the assessed value of shared equity homes.
- The legislation should cover both restricted leasehold interests and restricted fee interests held by shared equity homeowners, as is the case with the North Carolina legislation.
- Like the Florida legislation, it should allow for the full range of household incomes that shared equity homeownership programs are likely to serve, including moderate incomes up to 120% of AMI.
- Like the Florida and North Carolina Legislation, it should mandate specifically that the assessed value of shared equity homes not exceed the purchase option price established by the restriction.
- It should also limit the assessed value of the leased fee interest in land held by CLTs – either by providing for full exemption as the Florida legislation does, or by limiting the assessed value to the present value of future lease fee revenue.

### ***Sample Legislation***

#### **Vermont**

(32 V.S.A. §3481 (1), effective April 1, 2006)

“The estimated fair market value of a property is the price which the property will bring in the market when offered for sale and purchased by another, taking into consideration all the elements of the availability of the property, its use both potential and prospective, any functional deficiencies, and all other elements such as age and condition which combine to give property a market value. Those elements shall include a consideration of a decrease in value in non-rental residential property due to a housing subsidy covenant as defined in section 610 of Title 27, or the effect of any state or local law or regulation affecting the use of land, including but not limited to chapter 151 of Title 10 or any land capability plan established in furtherance or implementation thereof, rules adopted by the state board of health and any local or regional zoning ordinances or development plans. In determining estimated fair market value, the sale price of the property in question is one element to consider, but is not solely determinative.”

## Florida

“**Section 1.** Section 193.018, Florida Statutes, is created to read:

193.018 Assessment of improvements on lands used by a community land trust to provide affordable housing.

As used in this section, the term "community land trust" means a nonprofit entity that is qualified as charitable under s. 501(c)(3) of the Internal Revenue Code and has as one of its purposes the acquisition of land to be held in perpetuity for the primary purpose of providing affordable homeownership through the conveyance of structural improvements located on such land, subject to a ground lease having a term of 99 years, while retaining a preemptive option to purchase any structural improvements on the land at a price determined by a formula that is designed to ensure that the improvements remain affordable to persons who meet the income limits in s. 420.0004(8), (10), (11), or (15). In assessing property for ad valorem taxation under s. 193.011, an improvement used for affordable housing on land owned by a community land trust and subject to such a ground lease shall be assessed under the following criteria:

- (1) The amount a willing purchaser would pay a willing seller shall be limited to the restricted price at which the improvement may be sold.
- (2) If the ground lease and all amendments and supplements thereto, or a memorandum documenting how such lease and amendments or supplements restrict the price at which the improvements may be sold, is recorded and filed in the official public records of the county in which the leased land is located, the lease and any amendments or supplements shall be deemed a land use regulation during the term of the lease as amended or supplemented.

**Section 2.** Section 196.1978, Florida Statutes, is amended to read: 196.1978 Affordable housing property exemption. Property used to provide affordable housing serving eligible persons as defined by s. 159.603(7) and persons meeting income limits specified in s. 420.0004(8), (10), (11), or ~~and~~ (15), which property is owned entirely by a nonprofit entity that ~~which~~ is qualified as charitable under s. 501(c)(3) of the Internal Revenue Code and that ~~which~~ complies with Rev. Proc. 96-32, 1996-1 C.B. 717, shall be considered property owned by an exempt entity and used for a charitable purpose, and those portions of the affordable housing property which provide housing to individuals with incomes as defined in s. 420.0004(10) or ~~and~~ (15) shall be exempt from ad valorem taxation to the extent authorized in s.196.196. All property identified in this section shall comply with the criteria for determination of exempt status to be applied by property appraisers on an annual basis as defined in s. 196.195. The Legislature intends that any property owned by a limited liability company which is disregarded as an entity for federal income tax purposes pursuant to Treasury Regulation 301.7701-3(b)(1)(ii) shall be treated as owned by its sole member. The exemption provided in this section extends to land that is owned by a community land trust, as defined under s. 193.018, which provides affordable housing to persons meeting income limits specified in s. 420.0004(8), (10), or (15), is held in perpetuity for that purpose, and is subject to a ground lease having a term of 99 years for the purpose of providing such housing.

**Section 3.** This act shall take effect July 1, 2007.

## North Carolina

“AN ACT TO CLARIFY THE VALUATION OF COMMUNITY LAND TRUST PROPERTY.

**SECTION 1.** Article 12 of Subchapter II of Chapter 105 of the General Statutes is amended by adding a new section to read:

**"§ 105-277.17. Taxation of community land trust property.**

(a) Classification. – Community land trust property is designated a special class of property under Section 2(2) of Article V of the North Carolina Constitution and must be appraised, assessed, and taxed in accordance with this section.

(b) Definitions. – The following definitions apply in this section:

(1) Community land trust developer. – A nonprofit housing development entity that is an exempt organization under section 501(c)(3) of the Code and that transfers community land trust property to a qualifying owner.

(2) Community land trust property. – Improvements to real property that meet all of the following conditions:

a. A fee or leasehold interest in the improvements is transferred subject to resale restrictions contained in a long-term ground lease of not less than 99 years.

b. The community land trust developer retains an interest in the property pursuant to the deed of conveyance or the long-term ground lease.

(3) Ground lease. – A lease between the community land trust developer of a dwelling site, as landlord, and the owner or lessee of a permanent residence constructed on the dwelling site, as tenant. The leasehold interest of the tenant in the dwelling site includes an undivided interest and nonexclusive easement for ingress and egress to the dwelling site and for the use and enjoyment of the common areas and community facilities, if any.

(4) Income. – Defined in G.S. 105-277.1(b).

(5) Initial investment basis. – The most recent sales price, excluding any silent mortgage amount, of community land trust property.

(6) Qualifying owner. – A North Carolina resident who (i) “occupies, as owner or lessee, community land trust property as a permanent residence and (ii) is part of a household, the annual income of which at the time of transfer and adjusted for family size is not more than one hundred percent (100%) of the local area median family income as defined by the most recent figures published by the U.S. Department of Housing and Urban Development.

(7) Resale restrictions. – Binding restrictions that affect the price at which a qualifying owner's interest in community land trust property can be transferred for value to a subsequent qualifying owner or the community land trust developer.

(8) Silent mortgage amount. – The amount of debt incurred by a qualifying owner that is represented by a deed of trust or leasehold deed of trust on community land trust property and that earns no interest and requires no repayment prior to satisfaction of any interest-earning mortgage or a subsequent transfer of the property, whichever occurs first.

(9) Transfer. – Any method of disposing of an interest in real property.

(c) Valuation. – The initial appraised value of community land trust property in the year the property first qualifies for classification under this section is the initial investment basis. In subsequent general reappraisals, the value of the community land trust property shall not exceed the sum of the restricted capital gain amount and the initial investment basis. The restricted capital gain amount is the market value of the community land trust

property that would be established for the current general reappraisal if not for this classification (i) adjusted to the maximum sales price permitted pursuant to the resale restrictions effective for a hypothetical sale occurring on the date of reappraisal, if less, and (ii) subtracting the initial investment basis and any silent mortgage amount."

**SECTION 2.** G.S. 105-278.6(e) reads as rewritten:

"(e) Real property held by an organization described in subdivision (a)(8) for a charitable purpose under this section as a future site for housing for individuals or families with low or moderate incomes may be classified under this section for no more than five years. The taxes that would otherwise be due on real property exempt under this subsection shall be a lien on the property as provided in G.S. 105-355(a). The taxes shall be carried forward in the records of the taxing unit as deferred taxes. The deferred taxes are due and payable in accordance with G.S. 105-277.1F when the property loses its eligibility for deferral as a result of a disqualifying event. A disqualifying event occurs when the organization fails to construct property was not used for low- or moderate-income housing on the site within five years from the first day of the fiscal year the property was classified under this subsection."

## Chapter 18

# Project Planning and Pricing

Chapter 12, “Resale Formula Design,” addresses the ways in which resale formulas affect the *future* pricing of CLT homes. Generally these formulas treat the price originally paid by the homeowner as a *base price* beyond which the *resale* price is allowed to increase only to a limited extent. What this means is that the price set by the CLT when it sells a home for the first time will affect not only that first sale but each resale of the home over a very long period of time. For this reason, the initial pricing of a CLT home has special importance. The factors that a CLT must consider in setting that initial price include some long-term concerns that are not usually present in the pricing of non-CLT homes.

In this chapter we will first review the immediate considerations involved in pricing affordable housing (whether by a CLT or other affordable housing provider). Next we will look at some additional factors that must be considered when the goal is long-term affordability. We will then discuss the basic types of choices that a CLT must make in setting the initial price of a home.

### Immediate Pricing Considerations

The pricing of a CLT home involves two opposed sets of interests, with a third factor mediating between the two. On the one hand, a CLT has an interest in setting prices as high as possible in order to recover as much of its *cost* as possible. On the other hand, the CLT has an interest in setting the price as low as possible in order to make it as *affordable* as possible and as *marketable* as possible (and perhaps to comply with a *funder’s requirements*). Mediating between these upward and downward pressures – and relieving the tension between them to a greater or lesser extent – is the *subsidy* factor.

**Upward Pressures on Price.** Prices are pushed upward by the direct cost of producing the homes, by the CLT’s ongoing administrative costs, and by the costs of the various services that the CLT will provide to the owner-occupants of the homes.

*Direct project cost.* It is usually assumed that the price of the home must be high enough to allow the CLT to recover its direct investment in the property – that is, the total direct cost of acquiring and/or developing the property. Some portion of this cost is typically covered by a subsidy, but whatever amount is not subsidized must be paid by the purchaser. As emphasized in Chapter 19, “Subsidy Structure,” the subsidy may be channeled directly to the CLT, in which case it reduces the “settlement price” of the home (as distinguished from the “base price” in Chapter 12, “Resale Formula Design”); or it may be channeled to the homebuyer – one homebuyer at a time – in which case it does not reduce the settlement price but increases affordability by covering a portion of the settlement price *for* the homebuyer. In either case the CLT’s basic pricing concern is that the amount of the subsidy plus the amount actually paid by the purchaser – including what the purchaser borrows – must equal at least the total amount that the CLT has invested in the property.

For scattered-site CLT programs that involve the acquisition and/or development of one home at a time, it is a relatively straightforward matter to calculate the total direct cost of each home as a basis for pricing the home. For large projects that include multiple units, the relationship of cost to price may be somewhat more complicated. In such cases there are

likely to be substantial project costs (e.g. predevelopment and infrastructure costs) that are essential to the development of *all* of the units but that may not be allocated equally to each unit in establishing prices.

*Administrative costs.* Direct acquisition and development costs are not the only costs entailed by the overall process of identifying and acquiring property, planning for and carrying out its development, and marketing the resulting home(s). Clearly the process entails substantial “administrative costs,” or “overhead,” including the cost of all the staff time involved in the entire process. CLTs may budget and account for these costs in different ways, and funders may compensate the CLT for these costs in different ways and to different degrees, but in every case a CLT has an interest in recovering as large a portion of such costs as possible from the proceeds of the sale of the home, or from subsidies paid directly to the CLT. (The money received by the CLT for this purpose may be termed a “development fee” or an “administrative fee,” or simply “proceeds of sale.”) For multi-unit projects, administrative costs are among the “shared costs” that, as noted above, may be allocated differently among the prices of different units, adding more to some than to others.

*Cost of related services.* The services provided in conjunction with CLT homeownership programs vary greatly from one CLT to another. In the case of CLTs serving low-to-moderate income homebuyers in high-priced housing markets where demand for less-than-market-rate homes is high, a CLT may concentrate on producing and selling such homes while providing minimal ancillary services to the homebuyers. On the other hand, CLTs serving low-to-very-low income people in disinvested or otherwise distressed communities may provide a number of important services – from intensive pre-purchase counseling and training to post-purchase assistance on matters ranging from home maintenance and repair to efforts to address neighborhood problems. Such services are more likely to be funded through direct public or private grants to support these aspects of the CLT’s operations, rather than through revenue generated by selling homes. Nonetheless, it can be useful to recognize that these services are a significant part of the package of benefits that is being purchased by someone buying a home through such a CLT program. To the extent that some portion of the cost *can* be added to the selling price of a CLT home, without jeopardizing affordability, it is reasonable to do so.

**Downward Pressures on Price.** CLTs are concerned with reducing prices in order to make homes both affordable and marketable, and in order to comply with the regulations of subsidy programs.

*Affordability.* For all “affordable housing,” the issue of affordability is obviously a fundamental pricing consideration. If a particular income range has been targeted – e.g., households with incomes between 60% and 80% of area median income (AMI) – how low must the price of a home be if it is to be affordable? Or, if a particular price is projected, how high must a household’s income be if the price is to be affordable for that household?

We should note that for the homebuyer there are actually two separate affordability questions. First, how affordable is the total amount that must be paid “up front” (down-payment plus closing costs)? Secondly, how affordable are the monthly payments (mortgage payments plus taxes, insurance, and ground lease fees)? The answer to the first of these questions often has more to do with funders’ and mortgage lender’s requirements and the spending/saving habits of the particular household than with the price of the home and the

household's income. Nonetheless, it remains true that higher prices normally entail higher down-payments (established as a percentage of the price) and that households with higher incomes are better able to accumulate the cash needed to cover up-front costs. However, it is the affordability of the monthly payments that is usually the central consideration in establishing prices.

The affordability of monthly payments is usually calculated in terms of the relationship between the amount of the payment and the amount of the household's gross monthly income. As a rule of thumb, a CLT may aim at keeping the amount of the monthly payment at no more than 30% of gross monthly household income (the maximum percentage permitted by typical mortgage programs ranges from 28% to 33%). Thus, for example, if the goal is to determine the maximum price that will be affordable for a household income of 80% of AMI, and if this amount (as adjusted for a given household size) is \$30,000 per year – or \$2500 per month – then up to 30% of this monthly amount, or \$750, is available to cover the monthly payment on a home.<sup>1</sup> If this payment includes, say, \$200 for property taxes, \$25 for homeowner's insurance, and a ground lease fee of \$25 (a total of \$250), then \$500 remains to service mortgage debt. The CLT can then calculate how much debt can be amortized by this monthly amount on a given set of terms. For instance, with a 30-year fixed-rate mortgage at 7% interest, \$500 monthly payments will amortize a loan of about \$90,225. If we assume that a 5% down-payment is required, then the maximum total price that will be considered affordable for this household is about \$94,974.

It must be emphasized that this amount represents the *maximum* affordable price for a household earning *exactly* 80% of AMI, adjusted for a given household size. This would be an appropriate price if the goal of the CLT is to serve households between 80% and 100% of AMI, but this price is too high if the goal is to serve households between 60% and 80% of AMI. If a price is to be affordable for the full range between 60% and 80%, it should be calculated as the maximum affordable price for a household at 60% of AMI.

*Marketability.* In many housing markets it is safe to assume that the effective price of subsidized housing is substantially below its market value, so that the demand for housing at such a price will be strong and marketing such housing will be relatively easy. However, there are other markets in which the situation is not so simple. In many inner-city neighborhoods, for instance, the market value of a new or fully rehabilitated home is likely to be substantially less than the cost of producing the home. Thus a large subsidy may be required to bring the price down to the appraised market value of the home (so that most of the price can be financed with a first mortgage with an acceptable loan-to-value ratio). In fact, more subsidy may be required to bring the price down to market value (as determined by market appraisals and actual demand) than is required to bring the price down to what is affordable for the targeted income level. In such situations, the question of marketability effectively replaces the question of affordability as a critical pricing consideration. For a CLT that is trying to “turn around” a deeply disinvested neighborhood by developing homes for sale to owner-occupants, it will usually be necessary to “create demand” for those homes by offering them for sale at prices that are lower – perhaps much lower – than what would be required strictly on the basis of affordability.

There are also situations where a CLT finds that there *is* sufficient demand in such a neighborhood for good homes at a particular proposed price but then finds that buyers will be unable to obtain financing for homes at that price because the appraised value of the homes is

less than the proposed price (in some cases perhaps because appraisers have over-reacted to what they see as the negative features of an urban neighborhood). In such situations – if the CLT cannot persuade the appraisers (or the mortgage lender) that there is in fact a market for the homes at the proposed price – it may be necessary to find a way to reduce the price to the appraised value of the homes.

In less extreme situations, the market value of CLT homes may be higher than the CLT's subsidized price, but not a great deal higher. This may mean that a potential homebuyer can buy a conventional home in the open market for a price that is not greatly different from the price the CLT would like to receive for its resale-restricted home on leased land. In this case the CLT may need to look for ways to reduce its price further in order to compete with the conventional housing product in that local market.

*Program regulations.* The prices of subsidized homes are normally limited by the regulations of the public programs providing the subsidy. These regulations are usually stated not in terms of absolute price limits but in terms of the household incomes for which the homes must be made affordable. For instance, the regulations of the federal HOME program permit the use of HOME funds to subsidize homeownership only for households with incomes below 80% of Area Median Income, adjusted for household size. This means that the prices of any homes subsidized through this program must be affordable for a range of incomes below 80% of AMI.

Housing programs that subsidize homeownership may also limit prices by regulating the types and amounts of costs that the organization can pass on to the buyer. For example, public funders commonly limit the amount of administrative cost for which the organization may be compensated – with the limit usually expressed as a certain percentage of total project cost.

Internal regulations can also be a factor. For certain programs or projects, CLTs themselves often establish affordability guidelines that are tighter than the regulations imposed by the source of subsidy. For instance, a CLT may design a project to provide homeownership opportunities for very low income households – with incomes below 60% of AMI – even though the particular subsidy that is utilized can be used for projects serving households up to 80% of AMI.

It should also be noted that the mix of income levels that a CLT can serve – and therefore the prices that will be affordable for those served – can be limited by the requirements for tax-exempt status under Section 501(c)(3) of the Code. See Chapter 6, “Tax Exemption,” for information on this subject.

**Subsidy.** One of the inescapable program-planning and project-planning considerations for affordable housing organizations is the question of how much subsidy will be needed to create affordability for a given income level if it costs a given amount to produce a unit of housing.

As already suggested, the CLT's cost in producing homes and providing services to homebuyers must generally be covered by some combination of what is paid by the buyers and what is provided as subsidy from one or another source, or some combination of sources (including not only government programs but businesses, foundations, and other institutions and individuals that contribute money, goods or services). Subsidies may either be *project subsidies* (allocated to increase the affordability of housing produced through specified projects) or *operating subsidies* (covering some portion of the organization's overall operating costs). Here we will focus primarily on project subsidies, which have a more direct and

obvious relationship to the prices of particular homes, but we should note that, in many respects, the two kinds of subsidy are interchangeable from the CLT's point of view. Increased operating subsidies can reduce the organization's need to cover administrative costs and the costs of homebuyer services by charging higher prices for homes. Conversely, increased project subsidies can reduce the organization's need for operating support.

Project subsidies have the effect of either reducing the amount of the CLT's cost that must be passed on in the price (if the subsidy goes directly to the CLT) or reducing the portion of the price that the buyer must pay herself (if the subsidy is channeled to the homebuyer). When the subsidy goes directly to the CLT, the basic pricing equation (before other factors come into play) is *total cost minus subsidy equals price*. When the subsidy is channeled through the homebuyer, the basic equation is *total cost equals price, which in turn is comprised of subsidy plus what the homebuyer herself must pay*.

We should also note that a CLT homeowner's monthly housing costs can be subsidized not only by reducing the price of the house (thus reducing monthly debt service) but by reducing the amount that the homeowner must pay for the land (through ground lease fees). In fact, in many markets, land costs are high enough so that a CLT may use all of the available subsidy to cover or reduce this cost. In such cases, the price (as the amount paid by the homeowner to purchase the improvements only) will not be subsidized, but the monthly lease fee can be substantially less than what market rate ground rent would be (and substantially less than the monthly payments would be if the land were purchased outright with mortgage financing).

### **Long Term Consequences & Considerations**

CLTs are concerned that homes be affordable (and marketable) to income-qualified owner-occupants not only when they are first sold but each succeeding time they are sold. For this reason, CLTs are concerned not only with a home's initial price but also with its future price. This future price will depend on both the resale formula that the CLT adopts and the "base price" to which the formula will be applied. The consequences of various types of resale formulas are discussed in Chapter 12. At this point we will concentrate on pricing questions related to the long-term consequences of variations in the base price.

**Is the Eligible-Income Range Wide Enough for Future Conditions?** The income range that can be served with a price of a given amount is defined by a "floor income," which is the minimum household income for which the price is affordable, and a "ceiling income," which is the maximum household income permitted by the program(s) providing the subsidy (or in some cases the maximum income set by the CLT's own guidelines). The wider the eligible-income range, the easier it will be for the CLT to find an "income-qualified" household that is willing and able to buy the house. A narrow range can make it very difficult to market a home – unless the organization already has on its waiting list at least one eager, pre-qualified family whose income does in fact fit within that narrow range. If the organization does have such a buyer lined up, it may not be greatly concerned with how narrow the eligible-income range is. A CLT, however, must look beyond this first sale and ask whether the eligible-income range can reasonably be expected to be wide enough in the future to facilitate resale.

First, the CLT must remember that if demand for homes has slackened by the time the home is resold – thereby reducing the flow of applications from prospective buyers – it may be difficult, or even impossible, to find a buyer whose income fits within the narrow range.

Secondly, the CLT should remember that the eligible-income range itself, though it may grow over time, may also shrink or even close up entirely – depending not only on the nature of the resale formula, but on changes in other factors, especially changes in mortgage interest rates. If interest rates increase significantly, thus increasing the monthly payment required to amortize a loan of a given amount, then the minimum income required to qualify for that loan will increase, with the result that the eligible income range may shrink. Interest rates are among the factors that a CLT does not control. Therefore CLT's should generally try to set prices that will create eligible-income ranges wide enough so that a certain amount of shrinkage in the range will not cause problems.

**Is the Market Advantage Great Enough for Future Conditions?** As we have suggested, the *demand* for a home at a given price can sometimes be at least as important a consideration as the *affordability* of the price. If there is a relatively small difference between the price of a CLT home and the prices of comparable homes being sold conventionally in the open market, then demand for the CLT home will be limited and the home may be difficult to market. If the difference between the CLT price and the “market-rate” price is *just enough* to allow initial marketability, there will be no assurance that the resale price will be low enough under future market conditions to allow the CLT home to be successfully marketed at that price. If market prices have declined at the time of resale, it may be necessary, in order to sell the CLT home, to reduce its price substantially below the “formula price” – with the result that a portion of the subsidy will be lost and/or a portion of the owner's equity will be lost. Just as there is long-term advantage in a wide eligible-income range, there is also long-term advantage in a wide market advantage that will weather the ups and downs of the market.

**Will the Subsidies that Create Initial Affordability Be Available in the Future?** As emphasized in Chapter 19, “Subsidy Structure,” subsidies that are channeled directly to the CLT, are “locked in” and become permanent, whereas subsidies that are channeled through the homebuyer may or may not be available to the next homebuyer. As noted in that chapter, a CLT should try first to have all subsidies channeled to itself. If a subsidy must be structured as a deferred loan to the homebuyer, the CLT should try to arrange to have the loan *permanently deferred* (not forgivable or repayable over time) and *assumable* by the next homebuyer. If it is not assumable by the next homebuyer, the formula-based resale price will probably not be affordable for the intended income range unless the deal can be re-subsidized from another source.

CLTs should also look carefully at the long-term consequences of situations where the original price is rendered affordable by a mortgage interest subsidy (reducing the interest rate so that the buyer can amortize a larger mortgage loan with affordable monthly payments). There is usually no assurance that a future buyer will have access to equally advantageous mortgage financing. In the absence of such financing, the future formula-based price may not be affordable for the intended income range.

**Can the CLT Adjust Future Prices by Reallocating Subsidies?** In some cases a CLT may have opportunities to adjust future prices by repurchasing a home at the formula-based price, then reselling it at a price that is either higher or lower than the price it has paid the departing homeowner. In order to sell some homes for lower prices, the CLT must accumulate a “subsidy pool” or pool of “community equity,” some part of which may be reallocated to

lower the price of certain homes to create greater affordability (and/or marketability) where it is most needed in the future. Such a pool may be accumulated from several different sources.

*Unrestricted “subsidies” from private sources.* If, for instance, a home in reasonably good condition is donated to a CLT, which then resells it, the donated value may be passed along to a buyer who can only afford an unusually low price, or the home may be sold to a somewhat higher income buyer for a price high enough so that the CLT can use some of the proceeds to increase the affordability of one or more *other* homes.

*Public subsidies with expired regulations.* Most subsidies that flow directly to a CLT are tied to particular homes for a limited regulatory period. After the expiration of the regulatory period, the CLT may, if it chooses, reallocate some portion of the subsidy to one or more other houses where additional affordability or marketability is needed.

*Increasing affordability generated by resale restrictions.* Depending on the specific resale formula it uses, among other factors, a CLT may find that the formula-based prices of its resale-restricted homes are becoming increasingly affordable – in effect increasing the amount of “subsidy” in each home. The CLT may choose to leave this additional “subsidy” in the homes that have “generated” it, or the CLT may choose to re-allocate some portion of it to increase the affordability of other homes.

It is of course true that this “subsidy pool” is not very liquid – unless, through a series of “profitable” resales a pool of cash is built up. If there is not a pool of accumulated cash waiting for the CLT to dip into it whenever a little extra subsidy is needed, subsidies can be re-allocated only when a home that has unrestricted subsidy invested in it is sold (and then only if the CLT *either* exercises its purchase option directly so that it can resell the home for a price high enough so that some of the proceeds can be used to subsidize a different home *or* charges a high enough fee for the assignment of the purchase option so that some of the proceeds can be used to subsidize a different home). Nonetheless there may be times when several homes are being resold in a limited period of time and when it makes sense to reapportion affordability among them by reallocating subsidy. CLTs certainly should not make their initial pricing decisions with the assumption that they can always make adjustments in future prices. Especially for younger, smaller CLTs the opportunities to adjust prices will be rare. For the very long term, however, the CLT’s ability to accumulate a significant “subsidy pool” is a potential strength that should not be ignored.

## Choices

Our review of both immediate and long-term considerations has already suggested some of the tradeoffs – and therefore some of the choices – involved in pricing CLT homes. Some of the more common types of choices are discussed below.

**Affordability vs. Cost Recovery.** As we have indicated, there is a fundamental tension between the CLT’s interest in setting initial prices as *low as possible* in order to serve households at the lowest possible income level and/or to create the widest possible eligible-income range, and the CLT’s interest in setting the price as *high as possible* in order to recover the largest possible portion of its costs – including administrative costs. This tension pervades CLT planning activities from the time of basic program planning onward.

As soon as it begins planning a program, the CLT must ask what income level (or levels) it intends to serve, what price is affordable for this income level, and what direct costs will be entailed in acquiring and/or producing decent housing for this clientele in the local market.

At the same time it must determine what kind of operation (how much and what kind of staff, what facilities, equipment and services) will be necessary to support the intended program, and it must then address the question of how the cost of this operation is to be met (to what extent through development fees or proceeds from the sale of homes; to what extent through direct operating support from other sources).

As program plans are translated into specific project plans, the basic tension between affordability and cost continues to shape the choices that the CLT makes. And even when a project is complete and the home or homes are ready to be sold, the tension sometimes remains. If the project is somewhat over-budget, will the CLT keep the price as planned while taking less money from the proceeds of sale to cover its own costs, or will it (if possible) increase the price enough to take from the proceeds of sale the amount previously planned? Conversely, if the project is under-budget, will the CLT pass the saving on in the form of an extra-affordable price, or will it keep the price as planned and recover a larger share of its cost from the proceeds of sale?

**Subsidy Allocation.** If the supply of subsidy were unlimited, there would be no limits on a CLT's ability to reduce the prices of the homes and housing-related services, wherever and for whomever it chose and to whatever extent it chose. Since this is not the case, CLTs (and all other affordable housing organizations) must make difficult decisions regarding how to utilize – or plan to utilize – the limited supply of subsidy that is available.

Let us look, for example, at a hypothetical CLT whose service area extends, let us say, from inner-city low-income neighborhoods where housing prices are depressed to inner-ring suburbs where prices are moderate to outer suburbs where prices are high. Let us assume, for the sake of discussion, that this CLT has received an annual funding commitment of \$200,000 to be used to subsidize as many homes as possible, given the particular programmatic goals of the CLT in the metropolitan area that it serves. In deciding how to allocate this subsidy, the CLT must make the three fundamentally important kinds of choices discussed below under the headings “breadth vs. depth,” “which homes for whom,” and “present vs. future.” The same kinds of choices must be made in one way or another by virtually all CLTs, whether they have already received a subsidy commitment that can be allocated in different ways, as in our example, or are at the point of deciding how to frame a project proposal in which the specific questions of subsidy allocation must be answered up front.

*Breadth vs. depth.* The CLT in our example might choose to spread the \$200,000 evenly over ten homes, reducing the price of each home by \$20,000. Or it might choose to concentrate the \$200,000 as deep subsidy in just five homes, reducing the price of each by \$40,000. Or it might choose to subsidize some homes more deeply than others – say, putting \$40,000 subsidies into each of three homes and \$20,000 subsidies into each of four homes. How broadly the subsidy is distributed – among how many homes – depends of course on how much is needed to achieve prices that are affordable and marketable to a given clientele while allowing the CLT to cover its costs.

The answer to the question of how much subsidy is required to achieve this effect for each subsidized home depends on how the questions discussed below are answered. There is often a temptation – particularly in framing proposals for funders – to shape the answers to these questions in such a way as to allow the highest possible number of “affordable units.” More often than not this approach will impress the funders, who generally want to be able to claim as many affordable units as possible for the funds at their disposal. No doubt there are

situations in which this is the best approach. However, CLTs often need to make the case that the measures of a program’s success must relate to the particular goals of the program. (In any case, a CLT should make the case that any subsidy invested in a CLT home buys affordability not just for one homebuyer but for a succession of homebuyers, so one should count not just the number of initial affordable purchases but the number of affordable purchases that can be projected over time.)

*Where and for whom?* The CLT in our example may choose to utilize its subsidy in any of the three market situations that we have identified. Let us assume that the CLT’s average cost of acquiring and rehabilitating a home is \$75,000 in the inner-city neighborhoods, \$110,000 in the inner-ring suburbs, and \$150,000 in the outer suburbs. Let us then assume that current income levels, interest rates, and other factors are such that households of a given size between 80% and 100% of AMI (“moderate income”) can afford homes priced at \$94,000; those between 60% and 80% of AMI (“low income”) can afford a price of \$65,000; and those between 40% and 60% of AMI (“very low income”) can afford \$36,000.

Under these circumstances, the per-unit subsidy required to create affordability for the three different income groups in the three different markets would be as follows.

	Very Low 40% - 60% AMI	Low 60% – 80% AMI	Moderate 80% – 100% AMI
Inner-city	\$39,000	\$10,000	\$0
Inner-ring suburb	\$74,000	\$45,000	\$16,000
Outer suburb	\$114,000	\$85,000	\$56,000

In such a situation, consider the different ways that the available subsidy might be allocated to achieve each of the following goals.

1. To produce the maximum total number of “affordable units.”
2. To improve neighborhoods and create ownership opportunities for very low income households who are otherwise unable to own homes.
3. To promote mobility for lower income people and diversity of income levels in the target neighborhoods.

Given the first goal, the CLT could hope to sell at least 20 homes in the inner-city neighborhood to low-income households (60%-80% of AMI), with a subsidy of no more than \$10,000 per home (unless a deeper subsidy is necessary to persuade these households to purchase homes in this neighborhood).

Given the second goal, the CLT might seek to sell fewer homes – perhaps as few as five – to very low income households (between 40% and 60% of AMI) in the inner-city neighborhood, with subsidies as high as \$39,000 per home. More homes might be sold in the neighborhood to households with somewhat higher incomes, but, if neighborhood improvement is an over-riding concern for the CLT and if the neighborhood is currently very deeply distressed, the CLT might decide to produce only five homes and to subsidize the price of each by \$40,000 in order to stimulate demand for what would otherwise be hard-to-market homes.

Given the third goal, the CLT might concentrate on creating affordable homeownership opportunities in suburban neighborhoods where homes are otherwise priced far beyond the means of lower income households. In carrying out such an effort the CLT would probably not launch an extreme effort to place very low income households in the expensive outer-ring suburban market, since the \$200,000 that is available would not be sufficient to subsidize

even two homes. Instead, the CLT might concentrate on creating opportunities in the less expensive inner-ring suburban market for a mix of low and moderate income households (ranging from 60% to 100% of AMI), so a larger number of homes could be subsidized.<sup>2</sup> (In reality, of course, CLTs are likely to have multiple goals – particularly regional CLTs that serve different neighborhoods and market situations.)

*Present vs. future.* Whatever its immediate programmatic goals, an affordable housing organization may try to maximize the immediate impact of the funding at its disposal by allocating just enough subsidy to each home to make it affordable for, and marketable to, households of the intended income level. As we have suggested, however, the long-term purposes of a CLT may be better served by subsidizing each home more deeply (therefore perhaps subsidizing fewer homes) to increase the likelihood that affordability and marketability can be sustained in the future.

Of course, to project future circumstances is not a simple matter. Interest rates are hard to anticipate (but one can still note the *potential* for increase or decrease by viewing current rates in relation to historic highs and lows). Local housing markets, too, are hard to anticipate. There is no one rule of thumb that will tell a CLT how much “cushion” should be built into its pricing in order to accommodate future conditions. A CLT may need to project very different futures for different neighborhoods and different market situations. In the example suggested above, real estate values might be expected to appreciate rapidly in the outer-ring suburbs (assuring the future marketability of CLT homes offered for sale at restricted prices), whereas property values in the inner-ring suburbs might have begun to decline (potentially eroding the future marketability of CLT homes). The inner-city neighborhoods might be showing signs of gentrification that could be expected to transform the local housing market in a way that would make affordable CLT homes highly marketable in the future; or there might be reasons to think that property values in those neighborhoods will continue to decline to a point where even deeply subsidized homes will be difficult to sell for as much as the initial owners paid for them.

Difficult as these matters are to project, they represent necessary considerations for organizations with the long-term purposes and responsibilities inherent in the CLT model. They should be taken into consideration in establishing the initial prices of CLT homes. These base prices – and the considerations that go into setting them – also have an obvious bearing on the subject of Chapter 12, “Resale Formula Design.”

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<sup>2</sup> Each year the U.S. Department of Housing and Urban Development calculates and publishes adjusted area median income figures for every “Standard Metropolitan Statistical Area” (SMSA) in the U.S. and every U.S. county that is not included in an SMSA. The adjustments for household size do not reflect actual differences in the incomes of households of different sizes; they are calculated to reflect differences in housing needs and costs of different size households. Thus an income of \$30,000 for a one-person household might fall above the adjusted figure for 80% of AMI for a household of that size in a given SMSA and therefore would not qualify for a housing subsidy that is limited to incomes below 80% of AMI, whereas an income of \$30,000 for a six-person household in the same SMSA might fall below the adjusted figure for 80% of AMI and would qualify for such a subsidy.

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<sup>2</sup> For organizations concerned with achieving or maintaining 501(c)(3) status, the particular mix of income levels served has a critical bearing on such status. A mix of incomes that is too heavily weighted toward moderate-income may be a problem. See Chapter 6 for a discussion of this subject.

## Chapter 19

# Subsidy Structure

In typical affordable homeownership programs – including those operated by CLTs – the home is purchased with a small down payment and with a major part of the price covered by first mortgage financing with affordable monthly amortization. The amount covered by these financial components, however, is almost always less than either the cost of producing the homeownership unit or the unrestricted market value of the unit. The financial component that fills this gap between what it costs to produce or purchase the unit in the open market and what the homebuyer can afford is what is generally identified as *the subsidy*. The subsidy can derive from a grant or donation of land, materials, labor or money from a charitable source, but, for most projects, the bulk of the subsidy is contributed by government sources in the form of real estate or funding. A major advantage of the CLT approach over other approaches to subsidized homeownership is that the CLT can “lock in” the subsidy, so that the home does not need to be re-subsidized each time it is sold. However, the CLT can lock in subsidies *only* if the subsidies are “structured” in a way that *allows them to be* locked in.

### Permanent Vs. Homebuyer-by-Homebuyer Subsidies

In general, subsidies that are disbursed to the CLT itself are locked in as *permanent subsidies* and provide the basis for permanent affordability. Subsidies that are credited to particular homebuyers to create affordability specifically for their home purchases – *homebuyer-by-homebuyer subsidies* – are not locked in and cannot be expected to provide permanent affordability. To the extent possible, CLTs want the subsidies utilized by their programs to be permanent subsidies rather than homebuyer-by-homebuyer subsidies.

**Permanent subsidies.** Permanent subsidies may be disbursed to the CLT as either grants or deferred loans. When they are treated as grants, the CLT normally signs some form of “subsidy agreement” ensuring that the homes in question will be sold to members of the group that the subsidy is intended to benefit. Such grants may be recoverable by the grantor if the terms of the subsidy agreement are not honored for a specified period of time, but they are not treated as loans during that time. Subsidies treated as deferred loans are like grants in that they do not need to be repaid as long as the terms of the subsidy agreement are honored. They may be secured with liens on the CLT’s fee interest in the land, but they are usually forgiven – and the liens released – at the end of a specified regulatory period, so their effect is not much different from that of recoverable grants with similar regulatory periods. By structuring the subsidy as a deferred loan, the funder simply strengthens its ability to recover the subsidy if it is misused during the regulatory period. (Note, however, the possible concerns of leasehold mortgage lenders regarding liens on the CLT’s fee interest in the land, as discussed below).

It should be emphasized that the long-term effect of permanent subsidies does not depend on the specific use for which the subsidy is formally designated or to which it is put. That is, it may be designated and used specifically for the acquisition of property, or specifically for the development or rehab of property, or it may be awarded and used at the time of the initial sale of homes to create affordability for income-qualified buyers (while remaining an asset of the CLT, not of the particular homebuyer). It is true that

CLTs would normally rather receive permanent subsidies as early in the development process as possible, since it is money on which the CLT will not need to pay interest during the process, but except for this effect the designated use does not make a long-term difference.

It is also useful to note the relationship – or lack of relationship – between permanent subsidies and land costs. As we have said, the amount of the subsidy is normally determined on the basis of what is needed to make a given home affordable for households at a given income level. This amount may be more or less than the cost of the land. Although it is sometimes said that what makes a CLT home affordable is the fact that the homeowner “doesn’t have to pay for the land,” it is much more accurate to say that what makes it affordable in the first place is simply the subsidy. What *keeps* it affordable, however, is another matter. In effect, the CLT, is able to preserve affordability by attaching the subsidy to the land that the CLT owns beneath the affordable home, regardless of whether the amount of the subsidy is more or less than the actual market value of the land.

**Homebuyer-by-homebuyer subsidies.** Most subsidized homeownership programs utilize homebuyer-by-homebuyer subsidies, which usually take the form of one or another type of deferred loan to the homebuyer secured with a second mortgage on the home. These subsidies are never as certain to preserve long-term affordability as what we have described above as “permanent subsidies,” but CLTs are sometimes forced to make use of them for at least some of the subsidy needed in particular situations. It is important to recognize the differing long-term effects of the various types of homebuyer-by-homebuyer subsidies described below – and to do everything possible to avoid using homebuyer-by-homebuyer subsidies that cannot be passed on from one homebuyer to the next.

*Subsidies as assumable deferred loans to the homeowner.* If a CLT is forced to utilize a second mortgage deferred loan to a homebuyer as a source of at least some of the subsidy needed to make the home affordable for that homebuyer, then the CLT will definitely want that loan to be assumable by the next homebuyer. To the extent that such loans can never be forgiven or paid off and must be assumable, this approach allows subsidies to be recycled, though they are not locked into the CLT’s own land holdings and their value will not appreciate as property values appreciate (but a CLT may still be able to preserve the affordability of the home, depending on the type of resale formula used).

*Subsidies as fully recapturable deferred loans to the homeowner.* The full amount of this type of subsidy must be repaid, possibly with interest, to the subsidy source when the home is sold (regardless of how long the home has been owned). These subsidies are not “privatized” by the homeowner, but the subsidy source has no obligation to make the subsidy available to the next buyer of the home. In effect, the CLT will need to start all over again to find enough subsidy – whether from the same source or a different one – to make the home affordable.

*Subsidies as forgivable deferred loans to the homeowner.* This type of second mortgage deferred loan can be “privatized” by the homeowner. If the home is resold within a specified period of time – ranging in length from 5 to 30 or more years – then the loan must be repaid to the subsidy source at the time of resale. But, if the home is not

sold until this specified period of time has elapsed, then the loan is forgiven (never has to be repaid). In some cases, such loans are forgiven incrementally – e.g. 5% per year over a period of 20 years. Even if the loan is not forgiven – or is only partially forgiven – the subsidy source again has no obligation (and may have little or no capacity) to make a comparable subsidy available to the next buyer of that home.

*Subsidies as deferred loans that build equity for the subsidy source.* Sometimes called “shared equity loans,” subsidies structured in this way will “grow” over time as the unrestricted market value of the home grows. When the home is resold the subsidy source will be repaid the original principal amount of the loan plus a percentage of any appreciation in the home’s value equal to the percent of the original cost covered by the subsidy. For example, if a \$50,000 subsidy is applied to a home valued at \$200,000 – a subsidy thus covering 25% of the unrestricted value – and if the home is then valued at \$300,000 when it is resold, the subsidy source would reclaim the original amount of \$50,000 plus 25% of the \$100,000 in appreciated value (\$25,000), or a total of \$75,000. This is a good way for a government entity to preserve the affordability-producing potential of its subsidies, but it is not a desirable way of subsidizing a particular CLT home if the government entity has no obligation (as normally it does not) to reinvest that affordability-producing potential in the same home.

*Subsidies as partially deferred loans to the homeowner.* Some subsidies are structured as second mortgage loans on which the homebuyer does not have to make amortization payments for a specified period of time, but with monthly amortization required after that period has elapsed. The assumption is that the homebuyer’s income will increase over time so that she can begin to service the second mortgage loan as well as the first mortgage. Eventually the subsidy source may recover the full amount of the loan plus interest, but it has no obligation to make a comparable subsidy available to the next buyer of that CLT home. Not only will the CLT need to find more subsidy for the next homebuyer, but the first homebuyer who pays off the partially deferred loan will have paid something approaching an unsubsidized price for the home – which raises the question of whether it is appropriate for her resale price to be restricted. Such loans may be an appropriate way to make homeownership more feasible for certain (upwardly mobile) lower income people, but they are not an appropriate way of subsidizing CLT homeownership.

*Mortgage interest subsidies.* Mortgage interest subsidies reduce the homebuyer’s costs by reducing the interest rate on the first mortgage loan rather than by covering a portion of the purchase price with a second mortgage loan. Like the approaches identified above these subsidies do not create permanently affordable homes but they can substantially reduce the monthly mortgage payments of a homeowner. In addition, since they allow a larger portion of the monthly payment to be credited to principal repayment, these subsidies can substantially increase the rate of equity buildup for the homeowner – unless the homeowner is required to repay the subsidy at the time of resale. If there is no subsidy-recapture provision, the homeowner whose mortgage interest is subsidized will receive a higher return on her investment than other homeowners who have paid the same price and are subject to the same resale formula. See Chapter 12, “Resale Formula Design,” for a discussion of ways that CLTs may deal with this circumstance in designing resale price restrictions.

## Dealing with Existing Policies and Programs

Clearly, it is important for CLTs to do everything possible to see that subsidies flow into their projects in forms that will allow them to be locked in permanently – or at least be passed on to the next homebuyer. Because the types of homebuyer-by-homebuyer subsidies described above are so common, new CLT programs – particularly in jurisdictions lacking previous experience with CLTs – may need to invest a good deal of time and energy in efforts to persuade government agencies to modify the guidelines of existing programs, or even to design new programs to capitalize on the CLT's ability to lock in subsidies.

Some states and municipalities have both programs that provide permanent subsidies directly to the nonprofit developers of affordable *rental* housing and other programs that subsidize *homeownership* on a homebuyer-by-homebuyer basis, but do not have programs that allow subsidies to be allocated directly to CLTs for permanently affordable CLT homeownership units. In such situations, a CLT may pursue any of three possible strategies, depending on the nature of specific regulations for existing programs, the relative difficulty of amending these regulations, and the willingness of public officials to either modify existing programs or create new ones. The CLT may (1) try for amendment of the guidelines for the rental subsidy program to allow these permanent subsidies to be used for the development of permanently affordable owner-occupied CLT homes, or (2) try for amendment of the regulations of the homeownership program to allow homebuyer-by-homebuyer subsidies to be converted to permanent subsidies directed to the CLT rather than to specific homebuyers, or (3) leave existing programs as they are and try for a new program specifically designed to provide permanent subsidies for CLT homeownership (or, more broadly, for any form of permanently affordable homeownership).

When it is workable at all, the third strategy is most likely to result in a subsidy program that will work smoothly for the CLT's purposes. Modifying existing programs can be a tortuous business. Even public officials who recognize the wisdom of permanent subsidies for permanently affordable owner-occupied homes, and who are therefore willing to amend regulations of existing programs to allow such subsidies, may still resist changes in any number of detailed regulatory provisions that don't really fit the CLT's program. For a CLT that has carefully designed its own ground lease provisions and related program guidelines, the ideal situation is to be able to take its plans to a government agency and ask for a commitment to fund what has already been designed, rather than spending time trying to bend the CLT program and an existing government program to somehow fit each other. Nonetheless, in the absence of governmental willingness to establish a subsidy program specifically for permanently affordable homeownership, many CLTs will need to invest effort in negotiating reasonable modifications of existing programs – most often modifications of existing homebuyer-by-homebuyer subsidy programs. Some of the more common issues that may need to be addressed in these negotiations are summarized below.

**Common issues in adapting existing program regulations.** CLTs seeking to utilize existing homeownership subsidy programs – whether trying to adapt homebuyer-by-homebuyer programs to accommodate the CLT program or trying to utilize newly authorized “shared-equity homeownership” programs – may need to work out one or more of the following issues with program administrators.

*Administrator insistence on directing subsidy to homebuyer.* Getting program administrators – who are used to thinking of homeownership subsidies as being, by definition, subsidies *to* homebuyers – to actually agree to disburse the subsidy to the CLT is *the* big hurdle. You may think you have prevailed on this point with the officials with whom you’ve been negotiating but then find yourself presented with proposed subsidy documents that still describe the homeowner as the recipient of the subsidy. The problem may be simply that the attorney who drafted the documents had not got the message – or it may be the broader problem of a lack of clarity among program staff about how the CLT deal ought to work. In these situations there is no substitute for patience and perseverance. Some of the other issues noted below may be addressed through compromise without seriously undermining the CLT’s program, but on this issue, CLTs should be very slow to compromise.

*CLT must be eligible transferee through purchase option.* This is a technical point that is usually easily addressed with program attorneys or administrators, but it is important that the CLT makes sure that it *is* addressed. The regulations of existing subsidized homeownership programs typically permit the owner-occupant to sell the home only to other income-qualified households (unless the subsidy is to be recaptured by the source). The CLT should make sure that the subsidy documents also allow the home to be sold to the CLT itself, under the terms of the CLT’s purchase option, for resale to other income-qualified households.

*Homebuyer eligibility requirements.* Normally a CLT must simply accept the subsidy program’s guidelines regarding the maximum at-time-of-purchase incomes of households that will benefit from the subsidy. If the goal of the subsidy program is to serve households below 80% of Area Median Income but the CLT wants to sell a home to a family at 90% of AMI, then the CLT won’t be able to use that program to subsidize that home. There are some other kinds of eligibility requirements, however, that may be more negotiable. Some homebuyer subsidies, for instance, are limited to first-time homebuyers. Program administrators are not likely to allow exceptions to such a rule, but there might be some room for compromise regarding the definition of “first-time homebuyer” (e.g., someone who has not owned a home in the past five years vs. someone who has *never* owned a home).

*Criteria for possession of home by heirs.* The Model CLT Lease (Section 10.3) allows the heirs of a deceased lessee-homeowner to assume the lease and occupy the home, even if they are not income-eligible, if they are members of that homeowner’s family or if they have been living in the house for at least a year. Homebuyer subsidy programs often have more restrictive requirements on this matter. See the note on lease riders, below, if you plan to modify your lease on this point to conform to the requirements of a subsidy program.

*Removal of income qualification for purchaser after 6 months.* Article 10 of the Model CLT Lease allows a CLT home to be sold to someone who is not income-qualified

if the home has been on the market for at least 6 months and still has not been sold. Homebuyer subsidy programs typically do not make this exception (meaning that the subsidy would be recaptured if the home were resold to a non-income-qualified buyer). On this point, too, see the note on lease riders if you plan to modify your lease on this point to conform to a program's requirements.

*Lease fee levels.* At least one administrator of a state homebuyer subsidy program has argued that the homeowner could not be required to pay a ground lease fee, "because the subsidy is paying for the land, so the homeowner shouldn't have to pay for it." A similar program in a different state (Michigan) *requires* the CLT to charge a lease fee of at least a specified monthly amount, so it will have the resources needed to monitor and oversee resales over the long-term.

*Interest subsidy recapture issues.* As noted above, mortgage interest subsidy programs may require the homeowner to repay some or all of the interest subsidy out of the proceeds from the eventual resale. In the case of at least one such program utilized by CLTs – USDA's "section 502 direct loan" program – the amount of subsidy to be recaptured, for most borrowers, depends on the amount by which the value of the property has increased during the seller's tenure, as measured by the difference between the original purchase price and the home's market value at the time of resale. However, the Housing and Community Development Act of 1992 modified this provision for CLTs so that the interest subsidy is to be recaptured out of the difference between the purchase price and the *restricted resale price* rather than the unrestricted market value at the time of resale. This fact may need to be pointed out to Rural Development administrators when a 502-financed CLT home is actually sold.

**Liens on CLT's interest in the property.** When a home is subsidized through a deferred loan to the homebuyer, a second mortgage lien is normally recorded against the homeowner's title to the home to secure the loan. If the home is subsidized, instead, through a deferred loan to the CLT, the subsidy source usually wants to record a lien against the CLT's interest in the land. If such a lien is recorded *before* a homebuyer's leasehold mortgage is recorded, it will raise a concern for the potential leasehold mortgagee unless the subsidy source will sign an agreement promising to respect the terms of the lease and the leasehold mortgagee's interest in the lease in the event that the subsidy source should ever foreclose its lien on the land. (See chapter 20, "Financing CLT Homes," regarding the new and more workable treatment of this issue in the 2011 version of the "Fannie Mae CLT Ground Lease Rider.") If the lien on the CLT's interest is not recorded prior to the sale of the home to the homebuyer, that lien can be subordinated to the leasehold mortgage lien so that there will be no problem for the leasehold mortgagee.

**Use of Lease Riders to Modify Lease Terms to Satisfy Subsidy Sources.** In situations where a CLT agrees to modify the terms of its lease in order to arrange for a subsidy in the form of a deferred loan to the CLT, the changes should never be made in the main body of the lease, which should retain the terms that the CLT wants to apply for the long term. The deferred loan in such cases will normally be forgiven – and the lien released – after a specified number of years. Any modifications of the lease terms required by the subsidy source should be stated in a rider to the lease that will apply only for the term of the deferred loan – and will then expire. The "Fannie Mae Rider" is an example of a

similar lease rider reflecting the requirements of a leasehold mortgagee rather than of a subsidy source.

**Effect of Subsidy Structure on Resale Formulas.** Finally, it is also important to note that the way subsidies are structured can have a significant effect on the way that resale restrictions must be written. If the subsidy is to be held permanently by the CLT itself, then the amount of the subsidy is *excluded from* the “base price” that the homebuyer actually pays. If the subsidy takes the form of a deferred loan to the homebuyer, it is normally treated as *part* of the “settlement price” (as the price appears, for instance, in the “HUD 1 Settlement Statement”). In other words, the subsidy is treated in this latter case as part of what the homebuyer borrows to pay the settlement price. In such situations it is important to be sure that the formula is drafted in such a way that it is clear that the base price is *not* the settlement price. See Chapter 12, “Resale Formula Design,” for further discussion of this issue.

## Chapter 20

# Financing CLT Homes

This chapter deals with issues related to loans to CLT homebuyers or homeowners for the purpose of acquiring, refinancing, or improving their homes. Such loans are normally secured by mortgages on the improvements owned by the homeowner and the homeowner's leasehold interest in the land (for mortgagees' purposes, the improvements are treated as a *part of* the leasehold interest in the whole property, as explained below). These "leasehold mortgages" do not entail a lien on the CLT's fee interest in the land, so even in the event that the mortgage is foreclosed, the CLT will not lose its land. (It should be said that some CLTs *have* agreed to mortgage their land in order to arrange financing for their homebuyers, but the practice is not common and is not generally recommended.

It should also be noted at the outset that CLTs themselves often seek mortgage financing to acquire or develop property. In such cases, a leasehold interest has not yet been created and title to land and improvements has not yet been separated, so the lender's security will be just as it is with other conventional mortgages. Even in this situation, however, lenders may take an interest in the terms of the ground lease that will apply when title is eventually separated as individual homes are sold. Because these lenders are usually repaid out of the proceeds from the sale of homes to homeowners, they want to be sure that the proposed lease will not present an obstacle to the marketing and financing of the homes.<sup>1</sup>

In the early days of the CLT movement, relatively few banks were willing to make leasehold mortgage loans to CLT homebuyers. Often the motivation of those that did make such loans was the federal Community Reinvestment Act (CRA), which holds federally regulated banks responsible for meeting the credit needs of the communities in which they do business, including low-income neighborhoods. These CRA-motivated lenders were willing to hold some of these mortgages in portfolio, but generally they were either not able to sell them on the secondary mortgage market or were not willing to invest the time and effort required to arrange for their sale, so the number of such loans that a given lender would make remained limited. Since those early days, however, CLTs have worked to expand their access to both the private secondary mortgage market and to various government programs. Significant progress has been made in this matter, and continued progress can be expected.

In this chapter, we will look first at the basic concerns of lenders and CLTs with regard to CLT leasehold mortgages. We will then look at the ways in which CLT leases in general – and the Model Lease in particular – address these concerns. We will also look at issues relating to the effects of lease fees on the underwriting of CLT leasehold mortgages. And finally we will look at specific leasehold mortgage issues that arise with secondary market institutions and other large national financial institutions.

### **Basic Concerns for Lender and CLT**

Leasehold mortgages do raise a special set of concerns for the lender and for the CLT, as well as for the homeowner. Each of these parties has interests in both the home and the land where the home is located. Each is concerned with the way in which these interests are affected by the terms of the ground lease. And both must deal with these concerns in the course of negotiating the terms of leasehold mortgages for CLT homeowners.

**Lender's concerns.** The lender will of course want to be sure that the lease is a valid one, meeting all of the requirements of state law, such as that it be executed by duly authorized parties. The lender will also want to be sure that the lease is longer than the term of the loan so that the loan can be fully amortized before there is any issue of lease renewal. The lender will then want to be sure that the lease cannot be terminated as a result of a homeowner's failure to comply with its terms without at least advance notice to the lender and an opportunity for the lender to cure the lease default. In addition, the lender will want to be sure that the lease does not contain restrictions that, in the event of a mortgage default, would prevent foreclosure of the mortgage, or would then prevent a foreclosed home from being sold for a price high enough to allow the lender to recover its investment.

**CLT's concerns.** As with many other aspects of the CLT lease agreement, the CLT must balance its concerns on, one hand, with helping lower income households achieve the benefits of homeownership and, on the other hand, with protecting its own long-term interests and those of the community it represents. The CLT does not want its ground lease to limit the rights of either the homeowner or potential lenders so strictly that financing cannot be arranged.<sup>2</sup> At the same time, the CLT does want to establish limits that will prevent "predatory lenders" from taking advantage of lower income first-time homeowners.

The CLT is also concerned about protecting its own interests against the consequences of the possible foreclosure of a mortgage loan to a homeowner. As we have said, CLTs normally do not want to allow their fee interest in the land to be mortgaged. And even with mortgages that do not put the CLT's interest in the land at risk, the CLT remains concerned with retaining the control provided by the ground lease over the use, occupancy, and affordability of the housing *on* its land.

Ideally, the CLT would like to have all of its restrictions on use, occupancy, and resale apply to any homeowner under the ground lease, whether that homeowner is the original homeowner or one who assumes ownership subsequent to a foreclosure or the taking of a deed in lieu of foreclosure. But to prohibit the sale of a foreclosed property (and subsequent resales of the property thereafter) to anyone who is not a lower-income owner-occupant would be to restrict the property's marketability and market value to a degree that lenders cannot be expected to accept.

### **Specific Issues as Addressed in CLT Leases.**

Since most CLT leases are based on the Model Lease originally developed by ICE and revised by the National CLT Network (and posted in 2011), we will discuss a number of points with specific reference to the way they are treated in the Model Lease. This section will be most useful if read in conjunction with Article 8 of the Model Lease (in Chapter 11-A) and the commentary on that article (in Chapter 11-B).

**Permitted Mortgages.** Article 8 of the Model Lease permits mortgaging of the homeowner's property (the improvements and leasehold interest in the land) only with the written permission of the CLT (section 8.1). In the case of the mortgage loan with which a homeowner purchases a CLT home, the 2011 version of the Model recognizes the CLT's act of signing the Lease as constituting permission for the mortgage (section 8.2) since the lease and mortgage are executed at the same time and the CLT would not sign the one if it did not approve the other. For any subsequent financing (refinancing or subordinated mortgage financing), the homeowner must apply for separate permission from the CLT (section 8.3), as

is described later in this chapter. Article 8 then defines both the obligations and the rights of a “Permitted Mortgagee” (sections 8.5 and 8.6, which reference the “Exhibit: Permitted Mortgages,” where details are spelled out). These “rights” and “obligations” can be altered only if the CLT and homeowner agree to a “lease rider” stating that such alterations apply during the life of the mortgage.

**Term of the lease.** All lenders will require that the term of the lease extend at least far enough beyond the term of the loan so that there will be no danger of the lease expiring before the loan is fully amortized.<sup>3</sup> In practice, most lenders will not allow the lease to be within even a few years of expiring at the end of the term of the mortgage, since the liquidation value of the improvements and leasehold interest in the land is greatly diminished if only a short time remains before expiration of the leasehold interest.

These considerations are generally unimportant when a newly established leasehold is mortgaged, since CLT lease terms, like the 99-year term of the Model Lease, are normally far longer than the terms of most loans (see Chapter 10, “Legal Issues Re. CLT Ownership,” for discussion of legal issues related to lease terms). Furthermore, CLTs normally issue new leases each time homes are resold and thereupon re-mortgaged by new owners. The 2011 version of the Model Lease *requires* that a new lease be issued to a purchaser in such a situation. Older CLTs with leases that allow the lease to be assigned when the home is resold, rather than requiring the CLT to give a new lease at that time, may consider adding such a requirement to their leases in order to avoid the remote possibility of a situation where an uncooperative successor to the CLT as land-owner might render a home virtually unmarketable by refusing to issue the new lease that would be required for mortgage financing.

**Termination.** Just as lenders are concerned with the term of the ground lease, they are concerned with any provision that could cause the termination of the lease during the life of a mortgage. This concern is magnified by the fact that termination can occur at an unpredictable time, making it difficult for lenders to have systematic plans for protecting their collateral. Lenders would therefore prefer that the lease be non-terminable.

The CLT, however, views its own ability to terminate the lease in certain circumstances as important. The lease contains certain requirements and restrictions, such as the owner-occupancy requirement, that are so essential to the CLT’s fundamental goals that they may merit termination of the lease relationship if they are violated. There are also provisions – such as those relating to lease fees, property taxes, and other financial obligations – that are essential to the CLT’s economic survival. The CLT therefore sees the right of termination in the event of default under the lease as a limited but necessary last-resort remedy.

The Model Lease is designed to protect the mortgagee’s interests in this matter while preserving the CLT’s ability to terminate the lease as a last resort. It requires the CLT to give the Permitted Mortgagee notice of any default under the lease by the homeowner and an opportunity to cure the default (Exhibit: Permitted Mortgages, Section B-6). The Permitted Mortgagee will usually then have the right to recover any sums expended in curing such default under the provisions of its loan agreements with the homeowner. (As noted below, however, non-monetary defaults may present a special problem, because they are difficult or impossible for a third party to cure.)

The mortgagee’s concern with termination can also be accommodated by allowing its interest in the leasehold to continue even though the homeowner’s interest has been

terminated. The Model Lease provides that upon termination and at the request of the mortgagee, the CLT will enter into a new lease with the lender (Exhibit: Permitted Mortgages, Section B-4).

**Default and foreclosure.** The mortgagee is concerned both with the process by which foreclosure can be completed and with the market value and marketability of the collateral upon the completion of foreclosure or upon the taking of a deed in lieu of foreclosure.

Regarding the process of foreclosure, mortgage lenders of course want the greatest possible freedom to move swiftly to a foreclosure, should they choose to do so.<sup>4</sup> The CLT, however, wants the best possible opportunity to prevent foreclosure – for the homeowner’s sake, and because (as noted below) foreclosure will usually mean that the CLT itself will lose control over the affordability and occupancy of the home. And if foreclosure cannot be prevented, the CLT wants an opportunity to regain control of the affordability and occupancy of the home.

The current Model Lease gives the CLT three sequential opportunities to deal with the situation (Exhibit: Permitted Mortgages, Section A-1-3):

1. The permitted mortgagee must send the CLT a copy of any notice of default that is sent to the homeowner, whereupon the CLT has a right to cure the default on behalf of the homeowner at any time during the period when the homeowner has a right to cure the default.
2. If the default is not cured during the cure period and the mortgagee begins foreclosure proceedings, the CLT must be notified and will then have a right, for 30 days, to buy the mortgage by paying the amount owed to the mortgagee.
3. If the mortgagee eventually takes title to the home through foreclosure, the CLT will have an option to buy the home back for the amount owed to the mortgagee.

CLTs will generally choose not to exercise their *right to cure* a mortgage default unless the CLT determines that the homeowner’s problem is a temporary setback, such as the loss of a job, and that the homeowner can be expected to have the long-term capacity to repay the CLT. In such situations the CLT can cure the default on behalf of the homeowner, with the homeowner signing a promissory note with an agreed-upon repayment schedule.

The *right to purchase* the mortgage will rarely represent a practical alternative for a CLT, since exercising it would mean entering into the role of a mortgagee with a delinquent borrower and probably having to pursue foreclosure on its own behalf. Nonetheless, the right is important in that it gives the CLT a place at the table from which to negotiate the best possible outcomes for the homeowner and itself. Often, in such situations the most practical scenario will be one in which, before foreclosure can take place, the CLT helps to arrange the resale of the home to an income-qualified buyer, with the mortgage loan being paid off from the proceeds of sale.

Only if these efforts to prevent foreclosure have not been undertaken or have failed would the foreclosure process move forward. Then, on the completion of foreclosure – if the Permitted Mortgagee takes title to the home – the CLT can have one further opportunity to regain control of the use, occupancy and affordability of the home, in the form of the option to buy the home from the Permitted Mortgagee.

If the CLT does not buy back the home, then the mortgagee can sell the home and leasehold interest in the open market. At this point, the mortgagee has a crucial interest in

selling the home at a price sufficient to recover the full amount owed, including the cost of foreclosure. The mortgagee therefore wants, pursuant to foreclosure, to be able to eliminate the resale restrictions (and sometimes the occupancy restrictions) from the lease. CLTs, though they would prefer to see these restrictions retained, have generally recognized the need to accommodate mortgage lenders on this point. The Model Lease permits the removal of resale restrictions in this situation (Exhibit: Permitted Mortgages, Section B-7). However, the Model also provides that, in the event these restrictions are removed, the CLT will be permitted to increase the lease fee to reflect the increased value of the home without such restrictions (Section 5.6).<sup>5</sup> In situations where land values are high and the amount of the lease fee has previously been subsidized, the increase in revenue for the CLT can be substantial. The potential increase may also give the CLT some bargaining power in dealing with a new homeowner-lessee. In at least one instance, the purchaser of a foreclosed CLT home has chosen to allow restrictions to be re-established in the ground lease in return for reduction of the lease fee to its previous level.

**Refinancing and subordinated mortgages: permitted and non-permitted.** The Model Lease, since its first draft, has required the CLT's permission for *all* mortgages on a homeowner's property, but not until the 2011 version of the Model has it dealt separately with mortgages subsequent to the homeowner's initial first mortgage financing. As noted earlier, a CLT is always in position to approve or not approve the mortgage financing with which the homeowner purchases the home at the time the lease is signed. Often, in fact, the CLT has been directly involved in discussing the terms of such financing with both the lender and the homebuyer. With *subsequent* financing, however, the CLT will not necessarily even know that the homeowner is seeking another mortgage loan.

Such loans have sometimes been made without a CLT's knowledge – occasionally on very unfavorable terms and sometimes for amounts that increase the homeowners total mortgage debt to an amount greater than the resale price permitted by the lease. And in some cases these mortgages have been written as though the homeowner owned the home in fee simple, making it clear that the lender not only had not read the lease but was simply unaware that there was a lease. When CLTs have eventually discovered the existence of these mortgage loans and have pointed out to the mortgagee that the homeowner does not own the land but leases it on terms that allow the leasehold to be mortgaged only with the CLT's permission – and that the lease does not assign any rights to a non-permitted mortgagee – it has usually been possible to resolve the situation on reasonable terms.

Nonetheless, these messy situations can still create financial difficulties for the homeowner and can make it more difficult to preserve the affordability of the home. CLTs have therefore sought more explicit measures to prevent such situations. Section 8.3 of the 2011 version deals with “specific permission for refinancing or other subsequent mortgages.” The section lists the information that must be submitted to the CLT with a request for such permission and identifies the criteria that the CLT will apply in considering whether to grant such permission.

### **Mortgage Lender's Concerns with Lease Fees**

**Effect on affordability.** Lenders are concerned with the ground lease fee as an addition to the homeowner's monthly housing costs. In calculating the amount of debt service – and thereby the amount of debt – that is theoretically affordable for a household with a given

income, lenders add the monthly lease fee to the other monthly costs commonly included (principal, interest, taxes, and insurance). Lenders also have an interest in the question of how much the ground lease fee may be increased during the life of a loan, both because such increases could potentially raise total housing costs to an unaffordable level and because they could reduce the market value of the lender's collateral in a foreclosure situation.

Thus, despite the fact that CLTs share the goal of keeping monthly housing costs affordable, some mortgage lenders may want the ground lease either to place very specific limits on any increases in the lease fee or to give the mortgagee the right to disallow increases it finds excessive.

**Effect on value of the leasehold interest.** The other important ground-lease-fee-related issue for mortgage lenders has to do with the way one calculates the mortgagable value of the leasehold interest – a calculation that can be crucial for the CLT and potential homebuyers. All mortgage lenders are of course concerned with the value of the collateral securing a loan, and will limit the amount of the loan to no more than a specified percentage of this value (the maximum “loan-to-value ratio”). In the case of leasehold mortgages, the collateral (what is owned by the homeowner and can be mortgaged) consists of the “leasehold interest,” or, as it is sometimes called, the “leasehold estate,” or simply the “leasehold”. (In other contexts we speak of the homeowner owning the *improvements and* a leasehold interest in the land; however, for purposes of appraising the mortgagable value of what the homeowner owns, it is customary to treat the value of the improvements as *a part of* the leasehold interest in the whole property: see Chapter 10, “Legal Issues Re. CLT Ownership”)

How does one appraise a leasehold interest? The basic principles involved in the process are simple enough. The lease separates the “bundle of rights” that constitutes “fee simple” interest in the land into two separate ownership interests, one of which is retained by the CLT as the so-called “leased fee” (not to be confused with the “lease fee” that is paid by the homeowner to the CLT), the other of which is transferred to the homeowner as the leasehold interests. The *value* that the property would have if held in fee simple equals the sum of the values of the two ownership interests created by the lease. Accordingly, the value of the leasehold interest equals the fee simple value minus the value of the leased fee. If we can determine the fee simple value and the value of the leased fee, we can then determine the value of the leasehold interest by subtraction.

The fee simple value of the land is determined by conventional appraisal methods, treating the land as though it were held in fee simple and disregarding the existence of the ground lease and its restrictions. The value of the leased fee is the present value of the stream of income that the CLT will receive as ground lease fee payments plus the reversionary value of the land to the land owner upon the expiration of the lease. Because of the very long term and renewability of CLT ground leases, the reversionary value is so remote as to be insignificant, so, for practical purposes, the value of the leased fee equals the present value of the stream of ground lease fee payments received by the CLT.

The amount charged as a CLT lease fee is typically less – and in some markets a great deal less – than what would be charged as a “fair market” ground rent. Therefore the value of the CLT's leased fee is typically quite low compared to the fee simple value of the land. The value of the homeowner's leasehold interest is therefore correspondingly high.

Detailed written guidelines for appraising the value of a leasehold interest are available, and appraisers in regions where leasehold financing is relatively common are familiar with

them. Such guidelines have been published by FHA, USDA, and Fannie Mae, among others. It is true that leasehold financing is still not common in many areas, and some CLTs may still have difficulty either in finding appraisers who are familiar with methods for appraising leasehold interests or in finding mortgage lenders who understand such appraisals. However, as the volume of CLT leasehold mortgages increases – especially as these involve national insurers and secondary market institutions – the difficulties should continue to diminish. Fannie Mae’s approval, in 2001, of specific guidelines for the appraisal of resale-restricted CLT leasehold interests has been particularly helpful.

### **Additional Concerns of Some National Institutions**

The potential importance of the three financial institutions noted above – Fannie Mae, FHA, and USDA Rural Development – has increased for CLTs as the demand for CLT leasehold mortgages has grown beyond what can be met solely through CRA-motivated local lenders that are willing to hold a limited number of CLT leasehold mortgages in portfolio. FHA (though its use still presents substantial problems for CLTs) is potentially important as the insurer of mortgages held by a number of mortgagees, including state housing finance agencies and other secondary market institutions. Fannie Mae, the largest of the secondary market institutions, has developed a special program for CLT leasehold mortgages, which is increasingly important in opening the door for larger scale CLT homeownership programs and has helped to increase acceptance of the CLT model among mortgage lenders generally. The home mortgage programs administered by the Department of Agriculture’s Rural Development Agency (the section 502 direct loan program and mortgage guarantee program) are important sources of financing for low-income rural homebuyers. Federal legislation explicitly provides for use of the 502 direct loan program by CLT homebuyers, and actual CLT use is increasing.<sup>6</sup>

These and other large national institutions share certain concerns that spring from the fact that they operate highly standardized programs that serve a great many communities and jurisdictions. They neither originate mortgage loans (except in the case of Rural Development’s direct loan program) nor service these loans. As far as possible they would prefer to avoid loans involving conditions that do not fit easily within their standardized practices or that rely on the involvement of a local institution to ensure compliance with all conditions by the mortgagee.

**Lease riders.** When these concerns cause one of these national institutions to object to specific provisions of a CLT ground lease, the matter may be addressed (if not otherwise resolved) through a ground lease rider that modifies or eliminates those specific provisions for as long as the institution has an interest in the leasehold (but does not permanently change the lease to which it is attached). In negotiating these riders, CLTs and their allies have first sought to persuade the institution to accept those provisions of the lease that are most important to the CLT’s approach to ownership. Then, to the extent that specific lease provisions must be modified or eliminated, CLTs and their allies have sought to include in the rider alternative provisions designed to accomplish the purposes of what has been modified or eliminated. (It should be emphasized that any concessions made to a particular lender should *always* be established through a rider, which will be applicable only for the life of the loan in question, *never* in the body of the lease itself where it would be applicable for the full term of the lease.)

In 2011 a new version of the “Uniform Community Land Trust Ground Lease Rider” was approved by Fannie Mae for use with CLT ground leases when a leasehold mortgage is to be salable to Fannie Mae. This version of the rider replaces the somewhat different earlier version and is authorized for use with CLT leases based on *either* the 2002 ICE Model CLT Lease *or* the 2011 CLT Network Model CLT Lease. The rider, together with other information about Fannie Mae financing for CLT homebuyers, can be found at [www.efanniemae.com](http://www.efanniemae.com).

In the case of FHA and Rural Development, there is not yet any one nationally approved “uniform” rider. However, as of this writing, the National CLT Network is engaged with discussions with the Home Mortgage Insurance Division of FHA in an effort to reach agreement on a “uniform rider” comparable to the Fannie Mae Rider. As noted below, these discussions also include efforts to modify certain FHA regulations relating to resale restrictions. It is hoped that once agreement is reached with FHA, a similar agreement can be negotiated with USDA Rural Development. All in all, there is hope that a more uniform and favorable approach to CLT ground lease issues is emerging among these national institutions.

In the meantime it is useful to have a basic understanding of the issues commonly addressed in CLT ground lease riders. The more significant of these issues are outlined below.

**Notice requirements and cure rights.** Fannie Mae, FHA, and Rural Development have generally not accepted lease provisions which, like those in the Model Lease, require a mortgagee to notify the CLT of a mortgage default by a homeowner and, thereafter, to notify the CLT of the mortgagee’s intent to initiate foreclosure proceedings. Their concern has been that they are not in position to see that notice is given by the servicer of the loan (who routinely collects payments and communicates with the borrower regarding any failure to make payments, and who would not be accustomed to notifying a ground lessor of a default by a ground lessee and might therefore overlook the requirement). Such a failure on the part of the servicer could make it difficult for the mortgagee to take undisputed title to the collateral through foreclosure. These and other larger institutions have therefore tended to reject the mortgage default notice requirements established for Permitted Mortgagees by the Model Lease and have sometimes insisted that a lease rider explicitly authorize them to declare a homeowner-borrower in default and to proceed to foreclosure without approval by or *notice to* the ground CLT. The result for the CLT is that it may not be notified of a problem that seriously affects its interests. Similarly, these institutions have tended to reject the requirement that the mortgagee notify the CLT if it intends to initiate foreclosure proceedings and give the CLT 30 days in which it may then buy the mortgage from the mortgagee. Again, the problem is not that the mortgagee will not normally welcome the involvement of a CLT in curing a default or possibly buying a non-performing loan. The problem is with what is seen as an unusual legal obligation that a servicer may fail to observe, thereby compromising the mortgagee’s right to foreclose.

It should be noted that in at least a few states this problem can be solved as a result of statutes that allow a borrower/mortgagor to file a request that a third party receive notice of a default and that then obligate the mortgagee to give such notice.

The consequences of the lack of required notice to the CLT have been mitigated in lease riders in several ways. First, some riders, including the Fannie Mae Uniform Rider (in Section E.1) have stated that the mortgagee and the CLT agree to “communicate and

cooperate” in efforts to deal with default situations insofar as such agreement does not impose a formal legal notice requirement upon the Mortgagee. Secondly, some riders, again including the Fannie Mae Rider, have established the alternative requirement that the homeowner herself must immediately notify the CLT if she receives a mortgage default notice from the mortgagee (see Fannie Mae Rider, Section E.1) Generally such riders have then established the CLT’s right to cure a default – with the right triggered not by a notice to CLT but by notice to the borrower-homeowner.

It should be noted that, in practice, a CLT’s ability to prevent foreclosure may depend more on its relationship with the homeowner than on a legal right to receive notice of a default from the mortgagee, since such notice is not likely to be given until the borrower is deeply in arrears. Successful intervention by the CLT is usually based on early communication of the problem by the homeowner-borrower, when there is still time to work out a solution. Nonetheless, formal notice rights and cure rights remain important because they ensure that the foreclosure process will not go forward without the CLT’s knowledge, and they give the CLT a formally acknowledged right to participate in ways that are as much in the mortgagee’s interest as in the CLT’s.

Finally, it is important to note that, while resisting conditions that would complicate the foreclosure process, some of these institutions, including Fannie Mae, have been willing to give CLTs the very useful option of buying back a property *after* foreclosure. This option – which for the CLT is likely to be preferable to the acquisition of a non-performing mortgage prior to foreclosure – is now established in the Model Lease, as noted above.

**Non-monetary defaults.** Mortgagees in general – and large national institutions in particular – are also concerned about lease provisions that create the possibility of any default that cannot be cured by the payment of money. A mortgagee can cure a monetary default by making the necessary payment, but violations of lease provisions regarding such matters as use, occupancy, and subleasing can normally be cured only by the homeowner. The institutions’ basic concern here is of course that they do not want the ground lease to be terminated as a result of circumstances they cannot remedy. Even if any default under the ground lease also constitutes a default under the mortgage, so that the mortgagee has grounds on which to initiate foreclosure, and even though the Model Lease protects a Permitted Mortgagee against termination during a foreclosure process, some national institutions have wanted the blanket protection of a lease rider that simply eliminates the possibility of non-monetary defaults during the term of the mortgage. For a CLT, however, giving up all legal recourse in the event of violations of such basic requirements as owner-occupancy is a serious problem.

CLTs have addressed the problem in two ways. The first way involves writing into the lease a clause that allows the CLT to impose monetary penalties for violations of non-monetary provisions. Assuming that the penalties can be high enough so that the homeowner (and mortgagee) will not choose to pay them as an acceptable price for continuing whatever activity is at issue (e.g., absentee ownership), the CLT will have a means of converting a non-monetary default into a monetary default, which will then constitute grounds for termination of the lease if this recourse is finally necessary.

The second approach to the problem has been to establish a provision in the ground lease rider to the effect that a violation of non-monetary lease provisions, though not a default as such, does constitute grounds for the CLT to exercise its preemptive option to purchase the

home from the homeowner. (The 2011 Model Lease does allow the CLT to exercise its purchase option as an alternative to termination of the lease in the event of a default [section 12.4(b)], but the CLT's right to do so depends on recognition of a lease violation as an "event of default," which would not be the case with a non-monetary violation if a rider prohibits non-monetary defaults.) Though the consequences of an exercise of the purchase option may be virtually the same as when a lease is terminated, institutions have generally accepted this provision in a rider since it assures them that the loan can be repaid out of the proceeds from the CLT's purchase of the mortgaged property.

The Fannie Mae "Uniform Community Land Trust Ground Lease Rider" *does* allow non-monetary defaults in the case of violations of the major restrictions regarding owner-occupancy and resale of the home. It is encouraging that Fannie Mae has recognized that these restrictions are essential to the CLT's role in preserving affordability and owner-occupancy and has decided that it is reasonable to permit such restrictions. Given this important precedent – and given the fact that lenders generally gain more security than they give up through a CLT's long-term participation in affordable homeownership programs – we can hope that other national financial institutions will adopt similar positions.

**Liens on the CLT's fee interest in the land.** Lenders have a general concern that there be no prior liens on the CLT's fee interest in the land that could possibly affect the rights of an institution that had taken possession of the improvements and leasehold interest through foreclosure. A prohibition against such liens is a particular problem in those situations where a state or municipality or other funding source insists on a lien or deed covenant as a means of enforcing use and affordability requirements for subsidized property.

The 2002 Fannie Mae Uniform Rider (Section B) addressed this matter by specifying that a government entity may "hold a prior recorded interest on the fee estate" if the homeowner and the government entity enter into a written agreement to the effect that if the government entity ever "succeeds to the interest of the CLT," such entity and the homeowner will honor all of the terms of the lease including those intended to protect the mortgagee. CLTs and lenders found this solution difficult to implement because (1) it required the execution of a separate agreement for each mortgage transaction and (2) there was uncertainty as to exactly the form of agreement that would satisfy Fannie Mae. The 2011 version of the rider, however, eliminates these difficulties by (1) allowing the homeowner to agree to honor the lease in such a situation simply by signing the rider (as is required in any case) and (2) allowing the government entity to agree to honor the lease as part of a subsidy agreement with the CLT covering all transactions to which the subsidy in question will be applied. In addition, Fannie Mae now provides a sample "recognition and attornment agreement" that illustrates the kind of language called for.

**Other technical Issues.** The two issues discussed above have accounted for a major part of the time spent by CLTs in negotiating riders with national institutions. Other issues have either been less important for CLTs or have been raised less consistently by the national institutions, but some of them are worth noting here.

*Assurance of "permitted mortgage" status.* The national institutions have generally wanted lease riders to specify that the mortgage in question qualifies as a "Permitted Mortgage" under the terms of the lease. Assuming that the CLT has permitted or intends to permit the mortgage in question, it does not matter that permission is stated in the rider.

*Increases in lease fees.* As noted above, most mortgagees are concerned about the potential for increases in lease fees. The large national institutions tend to be more assiduous than others in seeking explicit assurances on the matter. FHA policies establish very specific requirements on the matter.<sup>7</sup> Others may want the right to approve fee increases (other than routine annual changes in any property taxes or other costs routinely passed through to the homeowner as part of the lease fee), or a right to receive notice of increases and to enter into arbitration on the matter if they consider the increases excessive.

*Approval of lease amendments.* These institutions have generally wanted a lease rider to stipulate – even though most if not all leases based on the Model Lease already do so – that any amendments to the lease adopted by CLT and homeowner while the mortgage is outstanding must be approved by the mortgagee before becoming effective.

**FHA and Rural Development policies affecting CLT restrictions.** The regulations for these government programs naturally involve public policy considerations as well as the legal and financial considerations of mortgagees and mortgage insurers. Appropriately enough, FHA and RD are particularly concerned that the deal being financed be not only financially sound from a lender's perspective but a fair deal for the homebuyer.

*Resale price restrictions.* These public policy concerns have resulted in policies defining the types of resale price restrictions that are to be permitted. CLTs of course share the concern that resale restrictions be fair to the homeowner; however, a number of CLT resale formulas reasonably designed to preserve affordability do not fit within the quite narrowly defined requirements embodied in FHA and RD policies.<sup>8</sup> In some cases, CLTs have developed ground lease riders that modify their resale formulas to meet these requirements, but all would prefer not to do so. CLT bylaws usually require super-majority votes of both the membership and the board of directors to change a resale formula, and, in any case, CLTs would prefer not to vary their duly adopted formulas to accommodate the specific requirements of a mortgage insurer or mortgagee. As of this writing, the CLT Network is actively seeking modification of these FHA requirements, so that the guidelines will be flexible enough to accommodate the range of formulas developed by local CLTs in their efforts to strike a reasonable balance between a fair return for the seller and affordability for the next buyer. The Network expects to approach Rural Development on this matter as well. CLTs should check the Network's website for updates.

*Enforcement of resale restrictions.* FHA regulations also limit the CLT's right to enforce resale restrictions. Such restrictions are permitted only if they are not "grounds for ... voiding a conveyance of the mortgagor's interest in the property, terminating the mortgagor's interest in the property, or subjecting the mortgagor to contractual liability [other than requiring repayment of subsidy]."<sup>9</sup> Terms complying with this provision have been written into some CLT ground lease riders, but CLTs would obviously like to avoid undermining important restriction in this way. Again, NCLTN is seeking changes in this provision, and CLTs should check the Network website for updates.

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<sup>1</sup> CLTs have often obtained financing for acquisition and development from nonprofit community development financial institutions that specialize in financing affordable housing projects. A number of these lenders place a high priority on permanent affordability and are familiar with the CLT model and its approach to resale-restricted homeownership on leased

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land. For this reason, they can often help CLTs introduce the approach to the more conventional lenders that are likely to be the source of long-term financing for CLT homeowners, and may help the CLT to negotiate with these lenders.

<sup>2</sup> Some early CLTs, established with a strong emphasis on removing rural land from the speculative market, adopted policies which, combined with lending practices of the time, made it difficult or impossible to get financing from institutional sources for homes on the CLTs' land. As a result, potential homeowners were limited to those people who either were willing and able to build very low-cost homes with their own labor and a little cash or were able to arrange loans from family or friends.

<sup>3</sup> In addition to the requirements of mortgage lenders, state law will sometimes require full amortization within a period that is shorter than the lease term by a specified degree – e.g. within 80% of the lease term. See, e.g., N.Y. Ins. Law, Sec. 1404(a)(6) (McKinney 1985); Mass. Gen. Laws Ann., Ch. 175, Secs. 63, 65 (West).

<sup>4</sup> States will vary in the amount of time that must be allowed before a foreclosure can occur through regulation of cure periods, procedural requirements such as notice provisions, and the like. See generally Nelson and Whitman, *supra*, pp. 488-501.

<sup>5</sup> Note that Section 5.6 of the Model Lease covers a wider range of possibilities than are specifically created by section B7 of the Model Permitted Mortgage Exhibit, which provides only for the removal of the restrictions contained in Article 10. Because some mortgagees have required lease riders providing for the removal of additional restrictions in foreclosure situations, Section 5.6 provides for an increase in the lease fee "in the event that the provisions of Article 10 regarding transfers of the Home or Sections 4.4 and 4.5 regarding occupancy and subleasing are suspended or invalidated..."

<sup>6</sup> Housing and Community Development Act of 1992, Section 703, amending Section 502(a) of the Housing Act of 1949, specifies that, for CLT homeowners, the interest subsidy will be recaptured out of the difference between the purchase price and the restricted resale price rather than out of the difference between the purchase price and unrestricted market value at the time of resale.

<sup>7</sup> FHA ground lease fee regulations are found in HUD Handbook 4150.1 REV-1, pp. 6-24--6-25.

<sup>8</sup> In the case of FHA, the specific requirements relating to resale restrictions are contained in the regulations (24CFR Section 203.41) and are interpreted in Mortgagee Letter 94-2. In the case of Rural Development's Rural Housing Services Program, the regulations contain a brief section on CLTs (7CFR Section 3550.72), which states that any restrictions imposed by the CLT must be reviewed and accepted by RHS. Specific criteria for acceptance of resale restrictions are then spelled out in an RHS Handbook (HB-1-3550, Chapter 9, pp. 9-12). These specific criteria appear to be based on, and are essentially the same as, the requirements spelled out in the FHA regulations.

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<sup>9</sup> 24CFR Section 203.41(d).

## Chapter 21

# Marketing, Buyer-Assistance, Buyer-Selection

Creating affordable homes for lower income people is one important part of the work undertaken by most CLTs, but their work does not end with the task of making the home available for purchase (and for some CLT programs the work doesn't *begin* until another entity has created the home). In any case, an important part of a CLT's work is the process of finding and assisting people who want, and are able, to take advantage of the ownership opportunity the CLT offers. It is not a simple process – especially when the goal is not just to see that the CLT homes are occupied but to see that the occupants will be successful as CLT homeowners. Furthermore it is a process that the CLT must expect to carry out more than once for each home it makes available. The CLT's work does not end with the first sale.

The process – whether for the initial sale of the home or a resale – entails a number of related, and sometimes closely interwoven, tasks, including the following:

- advertising the availability of the homes to potential buyers;
- counseling potential buyers to help them understand what it will take to buy a home (what they can afford, what it will take to qualify for financing, etc);
- orienting potential buyers so that they have a clear understanding of the nature of the CLT deal;
- documenting incomes of potential buyers to determine eligibility under the guidelines of subsidy sources;
- helping potential buyers qualify for leasehold mortgage financing on workable terms;
- selecting those to whom the CLT *will* sell homes;
- for those who have been selected, providing guidance and training – to assure that the transaction is properly completed and that the new homeowners will be equipped to succeed.

Of course, even after the completion of all these tasks, the CLT's work is still not done. See chapter 23 regarding "Post-Purchase Stewardship Tasks."

### Who Will Carry Out Which Tasks?

In the case of some CLT programs, the CLT itself must carry out all of these tasks – both for the initial sale and at the time of resale. In the case of other programs, some of the tasks can be carried out by other players.

**Developer partners.** If the CLT is to be the long-term land owner and steward but is not the developer of the homes in question, then the entity that is the developer may, or may not, have a significant role in the initial marketing. If the homes have been produced by a separate nonprofit organization, that organization may simply act as "turn-key developer," turning over ownership of land and houses to the CLT on the completion of development – along with its responsibility for marketing (and all other responsibilities). However if ownership of the land will not be transferred to the CLT until the homes are sold, the developer will have a substantial interest in seeing that the homes are sold expeditiously and may therefore insist on a substantial role in marketing the homes. In

any of these situations, it is important for the CLT to have a clear written agreement with its developer partner as to who will be responsible for carrying out what tasks.

It is also important that the CLT ensure that the homes are clearly marketed *as CLT homes* – in other words that the purchasers will have a clear understanding of how CLT homeownership differs from conventional homeownership. A developer-partner that must bear the costs entailed in holding the real estate until it can be sold can be tempted to de-emphasize the ways in which the CLT homes are different. Finally, with any such CLT-developer relationship, it is important to remember that, while the developers may play a significant role in the initial marketing of homes, they will have no involvement with resales, which, for better or worse, will be the CLT's responsibility.

**Partners re. “inclusionary units.”** If the CLT homes are a part of a larger for-profit development – as products of an inclusionary zoning requirement or other government efforts to create affordable housing opportunities for lower income households – then the developer may advertise and promote the “affordable units” as well as the market-rate units, and the government agency responsible for creating the affordability of these units may play a role in marketing and selecting purchasers or in establishing guidelines for these tasks. The question of who will perform what tasks – and under what guidelines – will be an important consideration in negotiating the CLT's relationship with such a government agency.

**Habitat partners.** CLT partnerships with Habitat for Humanity chapters are increasingly common and involve some distinctive practices and considerations. Normally in these situations the Habitat chapter will have full responsibility not only for developing the homes but for selecting and orienting at least the initial purchasers and for financing those purchases. The CLT's initial role will be limited to entering into ground lease arrangements with the purchasers and making sure that they understand their rights and responsibilities under the ground lease (which may be modified in certain ways to give the Habitat chapter an ongoing role as the homeowner's sponsor and mortgagee).

The marketing situation may become more complicated, however, at the time of resale. The Habitat chapter may want to play a role in selecting the next purchaser – especially if the first purchaser's tenure is relatively short – and may be prepared to finance that purchase on the same extremely affordable terms as the first. But over the longer term it is more likely that Habitat will want to leave the responsibility of dealing with resales to the CLT. It is therefore important that the two organizations enter into a carefully thought-out agreement regarding who will do what, under what future circumstances.

**Homebuyer counseling programs.** Counseling potential homebuyers is a critically important component of the overall process. Part or all of the necessary counseling may be carried out by the CLT – or by a “homeownership center” operated by the CLT but serving non-CLT homebuyers as well as those interested in CLT homes. Or a major part of the necessary counseling may be carried out by separate, specialized nonprofit programs (and a limited part may be carried out by mortgage lenders). CLTs will normally want to take advantage of any appropriate counseling that is available from other sources.

It is important, in working with such programs, that the CLT know exactly what information is being received by potential CLT homebuyers from such sources. Have

those sources accurately described the nature of CLT homeownership? In what ways should the CLT's own homebuyer orientation efforts supplement or qualify the information presented by separate counseling programs? Even when counseling provided by other sources is excellent in all respects, a CLT should expect to have an orientation program, carried out by its own personnel, for those who actually purchase CLT homes – if for no other reason than to personalize the relationship between the homebuyer and the CLT.

**Working with realtors.** CLTs may work with realtors in various ways. Most CLTs will want to explain their programs to local realtors and perhaps encourage them to mention these programs to lower income homebuyers who may not be able to afford homes available in the conventional market. But whether a CLT will actually contract with a real estate broker to market CLT homes is another matter. CLTs that do utilize brokers in a relatively conventional marketing role are likely to be those serving moderate income households and/or working with mixed income projects, where a broker may handle all of the units in the project. Those serving low and very low income households and/or working in low-income neighborhoods are more likely not to sell their homes through brokers. At least for the latter CLT programs, the disadvantages of working through brokers include the cost added by commissions, the need for special counseling and orientation that can better be provided by the CLT than by a realtor, the fact that most realtors have relatively little experience in working with low-income people, and the fact that most realtors are not likely to represent the CLT model as accurately or as persuasively as CLT personnel. Potential advantages of listing homes with brokers include the opportunity to utilize professional real estate sales people, and to reach potential buyers who are actively shopping for homes through a realtor.

It should be emphasized that contractual relationships between CLTs and realtors need not be conventional seller-broker relationships in all respects. CLTs may be able to negotiate special arrangements with local brokers whereby real estate agents and CLT staff can cooperate – each carrying out those parts of the marketing process that they are best positioned for – and whereby realtors' commissions may be reduced to reflect a more limited role, and/or to reflect a realtor's willingness to provide some services to a nonprofit on a pro bono or reduced-fee basis. At least one CLT has a close relationship with a nonprofit realty firm that specializes in the role of buyer's agent for low-income people and in selling homes in low-income neighborhoods.

A CLT may also have a special relationship with one or more brokers in connection with a "buyer-initiated program." With such a program, the CLT is not commissioning the realtor to market CLT-owned property; the CLT will be a co-purchaser of homes offered for sale by others through the realtor (with the CLT subsidizing the price and taking title to the land). It is in the CLT's interest that realtors understand the guidelines of the CLT's buyer-initiated program – what households will qualify for the program, how much subsidy they can qualify for, what housing types and price ranges (or what specific homes) are eligible – and it is helpful for the CLT and the realtor to agree on a process for determining who will handle what parts of the qualification process, and who will provide what kinds of assistance to those who do qualify. (See the note on buyer-initiated programs below.)

Finally, it should be noted that some CLTs have staff members who are themselves licensed real estate agents, which may be useful when it comes to developing cooperative

arrangements with other realtors – for instance in the case of buyer-initiated programs. In the matter of marketing CLT homes, however, the staff person who is a licensed agent will not necessarily be able to do a great deal more than other CLT staff can do.

## **Advertising**

The fact that your CLT is providing badly needed housing does not mean that crowds of eager people will be lining up at your door. Even in those housing markets where affordable housing is in the shortest supply, advertising is essential. And it must be timely and extensive enough to attract the attention of a great many more people than you have homes to sell. To sell one home you will probably need to identify a number of qualified potential buyers, and to find those qualified buyers you will need to generate many times that number of applications. And to generate that number of applications you will need to attract the attention of many times that number of people.

**When to advertise.** Obviously you don't want to wait until homes are ready for occupancy before beginning to advertise their availability. By that time you will want, if buyers are not already under contract, at least to have accumulated a sufficient pool of potential buyers whose household incomes are in the necessary range to qualify for the subsidies being utilized and who can reasonably be expected to qualify for mortgage financing as well. This means that advertising will need to have begun perhaps several months earlier. In fact, for most CLT programs, some form of advertising should be more or less continuous, with more concentrated efforts mounted if and when larger projects are approaching completion.

**Where to advertise.** Where can you make contact with people who will be interested in and can qualify for CLT homeownership? The first point to be made is that you cannot count on finding them among those actively shopping for homes. Most potential CLT homebuyers probably do not regularly check homes for sale in the real estate pages of the local paper or the web sites of local realtors (nor are they likely to check your CLT's web site until they have somehow learned that your CLT might be able to help them). They are likely to be people who do not believe homeownership is possible for them – either because they have tried and failed to find homes they could afford or have tried and failed to qualify for the amount of mortgage financing they believe they would need, or, more likely, because they simply assume homeownership is out of reach and don't know how to reach for it. They are tenants. Most of them have never owned a home.

Advertising targeted to such people can be posted in places they typically spend time or pass through in their everyday lives: apartment complexes, workplaces, schools, daycare centers, places of worship, stores, Laundromats – any frequented places where it is possible to post posters or leave leaflets. Radio and television ads can also be an effective way to reach people with an initial message, as can strategically placed ads in local print media (including weekly “shopper” publications). But the search for potential buyers may also need to be more proactive. Think of the institutions that might have reason to know of income-qualified people who may be ready to think about homeownership. These may include the local housing authority and other rental projects, municipal housing agencies, other nonprofits (especially those engaged in homebuyer counseling), and friendly realtors or mortgage lenders who may know of solid candidates who do not quite qualify for conventional home purchase. Contact them; ask for names

and ask them, also, to refer people to the CLT who they think might be right for its program. You cannot expect to get as many names through these referrals as you can get in response to your advertising, but the chances are that a much higher percentage of them will be appropriate candidates for what you are offering.

**Initial message.** The first step is to stir the interest of people who might be interested and give them a sense that the CLT might really be able to help them. The message should emphasize both the desirability of the homes being offered and the idea that owning these homes is a real possibility for those who don't otherwise have homeownership opportunities. Photographs are important. Information about location is important. Information about monthly payments (rather than total prices) is important. Information on how CLT homeownership works will of course be important, but it can come later. Finally the initial message should normally include the time and place of public presentations where interested people can get more information.

### **Follow-Up Presentations and Introduction of the CLT**

Group presentations for people whose interest has been engaged by your advertising are a typical second step in the marketing process. At the same time, these presentations are typically the first step in the process of introducing the CLT model. In planning them, however, it is important to remember that most, if not all, of those who attend will be there because they are interested in owning a home, not because they are interested in becoming a CLT member. You will want to present some basic information about the CLT, itself, but you won't want to spend a lot of time talking about organizational details when what people want is details about the housing – where it is, what it will cost (approximate monthly payments and down payment), what it takes to qualify as a purchaser and how the application-qualification process works.

You should spend a certain amount of time, however, in providing a clear basic explanation of the CLT's long-term relationship with the homes and the homeowner – in terms of both the assistance the CLT will provide and the restrictions on occupancy and resale that will be established by the ground lease. People do not need to leave the meeting knowing all about the CLT as an organization or all about the details of the ground lease, but they should certainly leave with a general understanding of how CLT homeownership differs from conventional homeownership – you don't want this difference to come as a big surprise when they are halfway through the application-qualification process – and they should leave with a general sense of the CLT as a friendly community organization that can give them more support and assistance than they would have if they were to purchase a home through conventional channels. (Orientation regarding the ground lease and CLT membership should become more detailed as potential buyers advance through the application-qualification process, and should culminate in measures to assure a thorough understanding on the part of those who finally become actual buyers.)

Oral presentations at these events should be given by CLT representatives who are able both to give a clear and lively description of the CLT's homeownership program and to give accurate answers to whatever specific questions are asked (while avoiding extended technical explanations). In general, basic presentations should be kept relatively short, with plenty of time left for questions. Information is likely to be

comprehended more clearly when highlighted in answers to specific questions than when embedded in a longer presentation.

Photographs of CLT homes – both the available homes that are being marketed and homes that are already occupied – should be a prominent part of these presentations. Short videos can be even better.

At some point during or at the end of the presentation, participants who have any interest in pursuing the possibility of CLT homeownership should be asked to fill out a simple form, which may or may not be treated as a homebuyer application form but which should at least provide the CLT with contact information, household size and approximate household income.

### **The Application-Qualification-Counseling Process**

The various steps in this process may occur in different sequences. The most obvious sequence involves the completion of an application form by a potential homebuyer, with whom the CLT then follows up to discuss that person's situation and then perhaps to document household income and other financial data, which may then lead to homebuyer counseling delivered either by the CLT or another organization. But it is also possible that a potential homebuyer will be referred to the CLT from a homebuyer counseling program (or possibly a mortgage lending program) where the person's household finances have already been discussed and documented and the person's basic eligibility for CLT homeownership has already been determined. Even in these cases, however, the CLT will want to confirm applicants' qualifications, discuss their situations with them, and clarify their needs and the likelihood that the homes the CLT is offering for sale can meet those needs.

**Application forms.** Application forms provide a formal mechanism by which potential buyers can tell the CLT that they are in fact interested in pursuing the possibility of buying a CLT home. The forms can be tailored to suit the particular CLT program and its goals and resident selection criteria, but what is essential is that they function as an efficient means of gathering the information that will be needed to determine whether an applicant meets the threshold requirements for the program in question and whether the size, location and other features of particular CLT homes will be appropriate for the applicant.

**Basic eligibility criteria.** In determining whether applicants meet basic requirements, three categories of information are critical: household income, household size, and "bankability." Virtually all CLT homes are subsidized to make them affordable for households with incomes that do not exceed specified levels, which are normally defined in terms of percentages of median annual income for the geographical area in question, adjusted for household size, as calculated and reported annually by HUD. The homes you are marketing may all be subsidized through a program requiring that they be sold to buyers with incomes below, say, 80% of area median income (adjusted for family size). Therefore, the first questions to be answered for an applicant are how many people are there in the household and what is the total annual income. If the annual income is *low* enough so that it does not exceed the limit for that household size for the subsidy program(s) in question, then the next question is whether the household's income is *high* enough to qualify for the mortgage financing that will be needed to purchase a home for the price that the CLT must receive.

For all applicants whose household incomes are low enough on the one hand and high enough on the other hand, you will then need to look at the other factors that will determine whether a lender will approve them for the necessary financing. These factors include their credit scores and the amount of existing debt that they must service in addition to whatever mortgage debt they may take on.

### **Final Selection and Preparation for Sale**

At any given time you may or may not have more qualified, ready buyers than you have CLT homes to sell. When you do have a surplus of qualified buyers, you may either allow the final determination to be made through a lottery or you may establish a selection process whereby qualified buyers are compared and a final selection is made based on stated selection priorities. Such a process must be careful, fair and transparent. In the absence of such a process, you should consider making the selection through a lottery.

**Priorities.** Selection *priorities* should be clearly distinguished from qualification *requirements*. The nature of these priorities and the process by which they are applied should be explained to all applicants. Common priorities may include the following.

*Income and affordability.* Among the applicants who are income-qualified, you may choose to assign a *higher* priority to those with lower incomes and therefore greater need. However, you might also choose to give a *lower* priority to applicants with incomes so low that they just barely qualify for the necessary mortgage financing and may therefore be more likely to have trouble making the mortgage payments.

*Household-size and composition.* Among applicants whose household size is acceptable for a given home, you may assign a higher priority to those who will make the best or most appropriate use of the home. For instance, you may choose to sell a four-bedroom home to a larger family rather than to a smaller family that could make do with a three-bedroom home. You may also consider the age and gender of children and the existence of any disabilities within the family for which the home would be particularly suitable (e.g., it would normally be a high priority to sell a wheel-chair-accessible home to a family that required wheel-chair-accessibility rather than to one that did not require it).

*Existing local residency.* You may choose to assign a higher priority to existing residents of the local area than to buyers who are just moving into the area.

*Travel efficiency.* You may assign a high priority to a household for which the location of the home will result in limited or energy-efficient travel to work, school and other necessary destinations.

*First-time homebuyers.* Even if your program is not limited to first-time homebuyers, you may choose to assign a higher priority to such buyers.

The process of considering multiple priorities can of course be complicated. You may simplify the matter somewhat by “prioritizing your priorities” – for instance by adopting a resident-selection policy that specifies that the *first* consideration will be to look for the family with lowest income that will still provide reasonable coverage of the necessary debt service. With such a policy you might consider secondary priorities only if you have multiple applicants who are roughly equal with regard to the first consideration.

**Who makes final decisions?** Ultimately the board of directors has final responsibility for decisions regarding the sale of real estate, but the board can receive recommendations from staff or a committee, and/or can authorize staff or a committee to make decisions based on board-approved criteria. Some CLTs maintain a “resident selection committee” that includes some combination of CLT homeowners, board members, and staff. Such a committee may interview final candidates in order to confirm their understanding and acceptance of the “CLT deal” – but the committee should resist the inclination to allow interviews to become “popularity contests.” In general, interview results should be treated as just one among a number of criteria. In any case, whoever makes the final decision should have a thorough understanding of the CLT’s selection priorities and all policies relating to the process through which they are to be applied.

**Fair housing restrictions.** The 1968 Fair Housing Act states: “In General, it shall be unlawful for any person or other entity whose business includes engaging in residential real estate-related transactions to discriminate against any person in making available such a transaction, or in the terms or conditions of such a transaction, because of race, color, religion, sex, handicap, familial status, or national origin.”<sup>i</sup>

Exactly what constitutes illegal discrimination in specific circumstances can of course be a matter of interpretation, and can be affected by state as well as federal law. If you have any doubt about whether any aspect of your buyer-selection policies and procedures could be considered illegally discriminatory, you should consult an attorney with an up-to-date knowledge of fair housing law within your jurisdiction.

**Managing waiting lists.** All CLTs that are successfully marketing homeownership opportunities should expect that they will sometimes have more qualified applicants than available homes. In fact it should normally be a CLT’s goal to maintain a waiting list of qualified applicants in order to avoid the cost of owning ready-to-occupy but unsold homes for significant periods of time, and in order to have qualified buyers to whom the CLT can assign its purchase option when an existing CLT homeowner wants to sell. Nonetheless, a waiting list that is too long can be a problem.

Ideally a CLT would like to have qualified buyers always available without having to make any of them wait more than a few months for an opportunity to purchase. But, especially for smaller CLT programs that can offer only occasional home purchase opportunities, it is difficult to strike this ideal balance between supply and demand. When demand does outstrip supply and the waiting list lengthens, it becomes important that the CLT maintain regular communication with those who are waiting. They should be kept posted on what homes may be available when, and they should be asked, regularly, to notify the CLT of any changes in their status and interests (are they still looking for a home; do they still want to buy a CLT home?) and any changes in their household income, household size, or overall debt service obligations.

Those on a waiting list – who will have been prequalified for a certain amount of mortgage financing – may also be reminded from time to time that their status as mortgage loan applicants can change for various reasons, including the effects of any additional debt service obligations that they may assume while waiting – for instance by taking out a loan for a new car.

Those on a waiting list can also be offered various forms of training or counseling during the waiting period. Their involvement in such programs is likely to be helpful to

them whether they do proceed to buy a CLT home or not, and will keep communication open between them and the CLT.

**Final orientation for those selected to purchase.** The time between the selection of a buyer and the closing of the sale to that buyer is the time to make sure that the buyer has a full, clear understanding – with support from legal counsel – of what she is buying and of the nature of CLT homeownership. See Chapter 22, “CLT Real Estate Transactions,” for discussion of items to be addressed during this period, including purchase and sale contracts, letters of agreement and attorney’s acknowledgement, etc.

**Training.** Some kinds of homeowner training may be provided – or may at least be launched – during this period. It is a time when buyers will of course be focused on the process of becoming homeowners and are therefore likely to be receptive to training that will help them succeed as homeowners. It is an excellent time to launch programs aimed at establishing sound financial management practices and sound home maintenance practices. See Chapter 23, “Post-Purchase Stewardship Tasks,” for more on homeowner training programs.

### **A Note on Buyer-Initiated Programs**

As mentioned above in connection with “working with realtors,” a number of CLTs operate “buyer-initiated” programs (sometimes called “buyer-driven” or “buyer’s choice” programs), which offer some significant advantages, but also have some potential long-term disadvantages.

The basic advantage of these programs is that the CLT is relieved of the need to either develop or market the homes sold in this way (though with some such programs the CLT may be involved in rehabbing buyer-selected homes). Buyer-initiated programs are therefore a relatively easy and inexpensive way for a CLT to help low-income homebuyers and to build a portfolio of permanently affordable resident-owned homes.

The basic disadvantage is that the CLT has less control of the nature of the portfolio that is being accumulated. There is a risk that the organization, in deciding what homes will be eligible, may be tempted to sacrifice the long-term quality and marketability of the homes because it is overly focused on the number of home it wants to sell in the present timeframe. It is therefore important that the CLT screen potential properties carefully before making them eligible for buyer-initiated acquisition. Homes that most CLTs will want to avoid in most cases include:

- homes that are likely to need repairs in the foreseeable future (unless funding is available to see that repairs are done at the outset);
- homes that are likely to require an amount or type of maintenance that will be a problem for low-income first-time homebuyers;
- homes that are on the upper margin of affordability with the subsidy that is available today;
- homes that, though they might be attractive to a particular current home-seeker, can be expected to have limited marketability over time;
- homes in deteriorating neighborhoods (unless the CLT has specifically targeted the neighborhood for improvement efforts);
- homes outside the CLT’s normal service area.

In general it is a good idea for those administering a buyer-initiated program to ask the question, “Is this a home that ten years from now we would want to own and need to find a buyer for?”

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<sup>i</sup> **Sec. 805. [42 U.S.C. 3605]**

## Chapter 22

# CLT REAL ESTATE TRANSACTIONS

Other chapters in this Manual deal with issues relating to the CLT's distinctive approach to the ownership of real estate. This chapter deals less with the approach itself than with the practical concerns involved in *implementing* that approach as the CLT enters into various kinds of real estate transactions.

Before discussing the distinctive features of CLT transactions and the practical concerns raised by those differences, it may be useful to note the nature of a simple, conventional real estate transaction. In such a transaction, there is a single "piece of property," the ownership of which is transferred, in its entirety, from a seller to a buyer. If the buyer is financing the purchase with a mortgage loan, then, in the moment in which the transaction takes place, the lender will provide some portion of the money that is to be paid to the seller and will receive a mortgage (or deed of trust) on the property purchased by the buyer. If there is a prior mortgage on the property, that mortgage will normally be released as the outstanding loan is repaid with a portion of the proceeds of sale. This type of transaction, with its four basic roles – buyer, seller, buyer's mortgage lender, and seller's mortgage lender – is familiar to many people. In the case of CLT transactions involving a ground lease and separate ownership of land and improvements, the basic roles do not change, but the property interests that are transferred do change – because we are no longer talking about a single piece of property; we are talking about several property interests that can be bought, sold, and mortgaged separately within a single transaction. Specifically there are three such interests:

- the CLT's fee interest in the land (also called the "leased fee");
- the homeowner's "fee interest" in the improvements;
- the homeowner's leasehold interest in the land (the bundle of rights conveyed to the lessee-homeowner by the lease – sometimes called the "leasehold estate").<sup>1</sup>

In this chapter we will look first at the limited ways in which state and local factors may affect the way a CLT transfers these property interests. Next we will outline the various types of CLT transactions in which these interests are involved. We will then discuss the distinctive concerns that a CLT must address in order to ensure that such transactions are properly carried out. The chapter ends with a sample check list of tasks to be performed as a CLT prepares for and completes a transaction.

### CLT Transactions in Varying State and Local Contexts

Though the basic nature of real estate transactions does not differ from one locality to another or one state to another, the ways in which the transactions are accomplished do vary somewhat. The roles of attorneys and title companies in closing property sales are not the same in every state. There are state-to-state differences in the governmental entities that are responsible for recording deeds, mortgages and other documents. Recording fees and transfer taxes – and the procedures for collecting them – differ from jurisdiction to jurisdiction. Different kinds of permits may be required for certain kinds of transactions in different jurisdictions. States differ as to whether real estate loans are secured with mortgages or deeds of trust. And other factors may vary as well – based on differences in governmental structure, state law, local statutes, and custom.

It is important for a CLT to work with a local real estate attorney who is familiar with the ways that real estate transactions are handled in that locality. But it is also very important that the local attorney be comfortable with the distinctive features of the CLT's approach to ownership – even if that approach will entail some transactions that are different from what he or she is familiar with. It should be remembered that what is *usual practice* and what is *legally possible* are not necessarily the same.

There are very few ways in which either the specific content of a CLT ground lease or the nature of transactions involving a CLT ground lease are affected by differences in state law. Ways in which the content *may* be affected are noted in the commentary on the Model Ground Lease. One factor that may sometimes affect CLT transactions is the fact that (as noted in Chapter 10, “Legal Issues Re. CLT Ownership,” as well as in the Model Ground Lease Commentary) there are some states where the standard practice (whether based on law or custom) is to treat improvements on leased land as personalty, rather than realty, and therefore to convey them with a bill of sale rather than a deed. (Where this practice prevails, the CLT's concerns with the *content* of such a bill of sale will be the same as the concerns noted below regarding the content of deeds for improvements only.) Also, in at least one state (North Carolina), questions have been raised regarding the basic practice of separating the ownership of land and improvements (see “Leases That Do Not Separate Title to Improvements” in Chapter 10, “Legal Issues Re. CLT Ownership”). And in two states (Maryland and Hawaii), significant complications are created by the fact that ground leasing is quite common and specialized laws have been developed to regulate the practice.

For the most part, however, CLT transactions are influenced much more significantly by the varying concerns of mortgage lenders than by variations in state law. Any CLT that is told by a local attorney that it must adopt practices significantly different from those of CLTs in other states should seek a second opinion.

## **Types of Transactions**

Before discussing the types of transactions that are specific to the CLT approach to ownership we should note that certain types of CLT transactions are entirely conventional. When a CLT acquires developed land – or land to be developed – it normally receives fee simple title to the property. If the acquisition is financed with a mortgage, it is the entire property, including any improvements, that is mortgaged. The fact that the property is being acquired by a CLT rather than by some other corporation or individual does not affect the nature of the transaction.

However, transactions that involve a ground lease and separate ownership of improvements on leased land are different. As we have said, three different kinds of property interest – the fee interest in the improvements, the fee interest in the land, and the leasehold interest in the land – can be transferred in such transactions. For CLTs, the possible types of transactions involving these three interests include the following:

1. CLT transfer of improvements and leasehold interest to a homebuyer.
2. Transfer of improvements from one homeowner to another, with a new lease executed by CLT and new homeowner – or, if the terms of the existing lease permit, an assignment of the existing lease to the new homeowner (the current version of the Model Ground Lease does not permit assignment).
3. Transfers from a third party to the CLT *and* a homebuyer (three varieties).

4. Transfer of improvements from a homeowner to the CLT, with termination of the lease.
5. CLT transfer of the fee interest in the land (either to the homeowner or to a third party).
6. Transfer of the CLT's interests *and* the lessee's interests to a third party.

The essential features of these six types are outlined below.

**Note:** In discussing these transactions here we identify the buyer or owner of the improvements as the “homebuyer” or “homeowner,” but the same types of transactions are possible with improvements used for nonresidential purposes.

**CLT Transfer of Improvements and Leasehold Interest to Homebuyer.** This kind of transaction takes place when a CLT has acquired or developed a home and then sells the house (the improvements) to a qualified homebuyer. The CLT transfers the *fee interest in the improvements* to the homebuyer by giving the buyer a deed for “improvements only.” At the same time, a ground lease is signed by the CLT as ground lessor and by the homebuyer as ground lessee, giving the homebuyer a *leasehold interest in the land*. The purchase is typically financed by a mortgage lender who takes a first mortgage on the fee interest in the improvements and the leasehold interest in the land – but not on the fee interest in the land that is retained by the CLT. (Such a “leasehold mortgage” is usually described as a mortgage on a leasehold interest that *includes* a fee interest in the improvements.) In some cases there may also be a “silent” second mortgage on the improvements and leasehold interest when such a mortgage secures a deferred loan to the homebuyer for the purpose of subsidizing the cost to the homebuyer.

It should be noted that, if land and/or development costs have been subsidized through a deferred loan to the CLT, the agency providing the subsidy may take – or may already hold – a mortgage on the CLT's fee interest in the land. (See Chapter 20, “Financing CLT Homes,” regarding the issue raised for mortgage lenders by this circumstance – and in particular regarding the way in which The Fannie Mae Uniform Rider allows the issue to be addressed.)

**Transfer of Improvements from One Homeowner to Another.** Once the ownership of the improvements has been separated from the ownership of the land, the improvements can be sold from one homeowner-lessee to another, with the purchaser simultaneously acquiring a leasehold interest in the land in either of two ways. The process required by the 2011 version of the Model Lease entails the CLT entering into a *new* ground lease agreement with the new owner, while terminating the seller's lease. The other process, permitted under previous versions of the Model and CLT leases based on those versions, entails the assignment of the existing lease, with the CLT's approval, from seller to buyer. In either case, the buyer's mortgage lender normally takes a mortgage on the leasehold interest (defined as including the improvements) at the point that the seller's mortgage on this collateral is paid off. If there has been a second mortgage (on the leasehold interest, including improvements) securing a deferred loan to the seller, that mortgage may be assumable by the new homeowner-lessee.

**Note:** When the improvements are sold from one homeowner-lessee to another it has been common for some CLTs to arrange, facilitate and oversee the sale without exercising their own option to purchase the home. However, the preferred practice for most CLTs is to formally exercise the purchase option and formally assign it to the new homebuyer, who can then complete the purchase in the way described in the paragraph above. In formalizing its

function in this way, the CLT has a basis for charging an “assignment fee” to the new homebuyer. It should also be noted that a CLT may charge a “transfer fee” to the buyer *without* exercising and assigning the option, as long as the lease explicitly permits the fee (as the 2011 version of the Model Lease does). Either type of fee will compensate the CLT for the costs entailed in assisting the homebuyer and arranging the sale. Such fees can be charged, at the discretion of the CLT, as long as the overall cost (assignment fee plus purchase price) is affordable for the buyer.

**Transfers from a Third Party to the CLT and a Homebuyer.** These transactions typically involve either a “turnkey” developer or a “buyer-initiated” homeownership program. In the case of the “turnkey” project, the property has been developed by a third party (either for-profit or not-for-profit), which owns the land during the development process. In the case of the buyer-initiated program, the buyer has found an existing home for sale on the open market. In either case, a CLT has agreed to acquire the land beneath the home, typically utilizing public funds at its disposal to cover some percentage of the cost of the whole property. Such third-party transactions can be structured in any of the three ways described below under “a,” “b,” and “c.” (Typically, multiple-party transactions such as these are executed in “simultaneous closings,” with either an attorney or a title company having responsibility for ensuring that all documents are properly signed, witnessed and recorded. In a simultaneous closing, the sequence in which documents are signed is not as important as the sequence in which they are recorded in the appropriate land records.)

- a) *Separate Acquisition of land and improvements by CLT and homebuyer.* In this case, the third party sells the homebuyer a *fee interest in the improvements only*, and sells the CLT a *fee interest in the land only*. The CLT then transfers a *leasehold interest in the land* to the homebuyer (signing a ground lease with the homebuyer). Normally, a mortgage lender takes a mortgage on the leasehold interest including the improvements. (Because it has only limited control over the condition of the premises and the improvements in a third party-transaction, a CLT may prefer to structure the transaction in this way to avoid any liability associated with such condition.)
- b) *CLT acquisition of property with immediate resale of improvements.* In this variation, the third party transfers a fee interest in the entire property, including improvements, to the CLT, which immediately transfers the *fee interest in the improvements* and a *leasehold interest in the land* to a homebuyer. As in the case of the approach described above, a mortgage lender normally takes a mortgage on the leasehold interest including the improvements.
- c) *Homebuyer acquisition of property with immediate resale of land.* This variation is similar to alternative “b” above, except that it is the homebuyer that first acquires the fee interest in the entire property from a third party. In exchange for the subsidy provided by the CLT, the homebuyer then transfers the *fee interest in the land* to the CLT, which in turn transfers a *leasehold interest in the land* back to the homebuyer. Again the normal practice is that a mortgage lender takes a mortgage on the leasehold interest including the improvements. (It should be noted that it is possible to structure such a transaction so that a lender takes a mortgage on the fee interest in land *and* improvements *before* the transfer of the land to the CLT – in which case, the fee interest in the land is transferred to the CLT *subject to* the mortgage, which continues to cover the fee interest in the land as well as improvements. The obvious

disadvantage of this approach, however, is that the mortgagee may then foreclose on the land as well as improvements.)

**Transfer of Improvements from Homeowner to CLT.** If the CLT wants to regain ownership of the improvements when the homeowner wants to sell, or if another qualified homebuyer is not immediately available (or if the ground lease must be terminated for other reasons), then the CLT may acquire the *fee interest in the improvements* from the homeowner-lessee and terminate the lease – whereupon the *fee interest in the land* and the *leasehold interest in the land* can be merged (once the seller’s leasehold mortgage has been released). The CLT then becomes the fee simple owner of the entire property, so it can grant a conventional mortgage on the entire property if there is reason to do so.

In some cases a CLT may acquire the improvements from one homeowner with the intention of immediately reselling them to a new homebuyer, with whom the CLT will sign a new ground lease. In effect, this scenario combines the type of transaction described here with the type described in #1 above. In most cases, however, it will be simpler and more efficient for the CLT to assign its purchase option to the homebuyer rather than actually acquiring and reselling the property itself.

**CLT Transfer of Fee Interest in Land.** This type of transfer – through which a CLT would actually give up its title to land that has been leased to a homeowner – is strictly limited by virtually all CLT bylaws, and is regulated as well by the terms of virtually all CLT ground leases. Nonetheless, such transfers can happen in unusual circumstances. Two versions are possible.

1. *Transfer to a third party subject to an existing lease.* If the CLT transfers the *fee interest in the land* to a party other than the lessee (e.g., to another nonprofit land stewardship organization), the *leasehold interest* and (or including) the *fee interest in the improvements*, and any mortgage on the leasehold interest, remain unchanged. (Note: Section 3.3 of the Model Ground Lease provides that if the Lessor attempts to sell the fee interest in the land to any party other than a charitable or governmental entity, the Lessee shall have a right of first refusal to purchase it.)
2. *Transfer to the lessee-homeowner.* If the CLT transfers the *fee interest in land* to the lessee/homeowner, the *fee interest in the improvements* and the newly acquired *fee interest in the land* may be merged, subject to provisions in the lease and mortgage assuring that the mortgagee’s interest will not be wiped out by such a merger.

**Transfer of the CLT’s Interests and the Lessee’s Interests to a Third Party.** For most CLTs in most circumstances, this possibility would be so remote as not to be worth mentioning. However, it can happen – and has happened – in circumstances where the CLT’s *fee interest in the land* has been mortgaged along with the homeowner’s *fee interest in the improvements*. If such a mortgage is foreclosed, the mortgagee can take possession of the *fee interest in the land* as well as the improvements and can merge the two interests, with the resulting termination of the leasehold interest.

### Concerns in Carrying out CLT Transactions

In carrying out any transaction involving a ground lease, a CLT has a fundamental concern with making sure that the three different kinds of property interests – fee interest in improvements, fee interest in land, and leasehold interest in land – are clearly distinguished

and clearly understood by all parties, and that the right interests are properly transferred to the right parties. In this section we will look at some of the more specific concerns that the CLT must attend to if it is to carry out its responsibilities in this regard.

**Orientation and counseling prior to sale.** Clearly the task of making sure that all parties understand the different property interests to be transferred in a transaction must begin well before the transaction actually takes place. The basic nature of CLT homeownership – what one does and does not buy when one buys a CLT home – should be emphasized in early efforts to acquaint prospective homebuyers with the homeownership opportunities offered by the CLT (see Chapter 21, “Marketing, Buyer-Assistance, Buyer Selection”). The fact that CLT homeownership is different from conventional homeownership should never be treated as a technicality that can be deferred until a later stage in the process. The nature of the deal is as important as the nature of the home and must be dealt with up front.

However, the fact that the basic nature of the deal must be clearly described up front does not mean that the matter can then be ignored from that time forward. The initial explanation of CLT homeownership on leased land will necessarily be a *summary* of something that is both unfamiliar and multi-faceted. It is important that this summary be broad and general enough so that it can be grasped with a reasonable degree of ease by people who are not already familiar with the concept. But even when there is an initial understanding of the concept, this understanding can fade and become confused as people learn more about the CLT and the opportunities it offers. CLT personnel should continue to listen carefully to what prospective homebuyers are saying, to make sure that they do understand the concept. At the same time there is a need to help prospective homebuyers develop a more detailed understanding of what they will be purchasing if they eventually sign a lengthy and rather complicated CLT ground lease. Clearly the task facing those who represent the CLT is a demanding one. It will take time to complete it. Enough time must be allowed so that it can be completed.

**Purchase and Sale Contracts.** The relationship between the seller and buyer of real estate is normally launched and defined by the signing of a purchase and sale contract between the two parties. The contract describes the property to be transferred and the price and other terms on which it is to be transferred. The contract obligates both parties to follow through with the transaction, on the terms described, provided that certain stated “contingencies” (such as approval of the necessary mortgage loan to the buyer) are met. Both parties therefore have a serious interest in making sure that the contract accurately describes what they are in fact prepared to do in carrying out the deal.

*When the CLT is selling the improvements.* With this type of transaction, it is obviously important that the contract make it clear that only the improvements are to be sold. But the contract should also go beyond this simple distinction. The nature of the ground lease, with its specific provisions, are an essential part of the deal. Therefore, the nature of the ground lease should be generally described in the contract, and the full text of the lease should be attached to the contract.

For example, the contract may state, following the description of the property’s location: “*The improvements only are to be sold, with the land to be leased through a renewable 99-year ground lease that includes, among other provisions, certain restrictions on the use,*

*occupancy and resale of the improvements. A full copy of this ground lease is attached to and included in this contract by reference.”*

CLTs may also want to include among the contract’s contingencies a requirement that, within a certain number of days, the purchaser must present the CLT with a “letter of agreement” (also called “letter of stipulation”), signed by the prospective purchaser, and a letter of attorney’s acknowledgement (signed by an attorney) – as these documents are described in the ground lease (see Model Ground Lease, Article 1). Of course, the prospective buyer might best review the ground lease and consult with an attorney concerning its meaning *before* signing a purchase contract. The contingency suggested here will ensure that this important requirement will be met, if not before the signing of the contract, at least before the contract becomes binding.

*When a homeowner is selling the improvements.* All of these concerns relating to the terms of the purchase contract are important for the CLT not only when the CLT itself is transferring the fee interest in the improvements and the leasehold interest in the land but also when the improvements are being sold from one ground lessee to another. In this case, the CLT is a necessary party to the transaction because (1) it must determine whether the household in question is an eligible buyer and whether the terms of sale are permissible under the ground lease; (2) having approved the household, it will usually assign its purchase option to the buyer; and (3) it must then be prepared to issue a new lease to the buyer.

The CLT’s involvement in such transactions can be addressed in the purchase contract in either of two ways. What is probably the more common way involves a two-party contract between the buyer and seller of the improvements, with the steps that must be taken by the CLT spelled out among the contract’s contingencies. In other words, the buyer’s right to purchase will be contingent on the CLT giving the necessary approvals and (in most cases) assigning its purchase option – as well as being contingent on other conditions, such as loan approval. The other way of addressing the matter involves a three-party contract, with both the lessee and the CLT agreeing to transfer their separate interests in the property contingent upon the prospective buyer demonstrating income-eligibility (if it has not already been demonstrated), submitting acceptable letters of agreement (or “stipulation”) and attorney’s acknowledgement, etc. The three-party contract may be more appropriate in situations where the prospective buyer has been identified and pre-qualified through the CLT’s own efforts. The two-party contract may be more appropriate in situations where the prospective buyer has been identified through the seller’s efforts. (Note that, if a three-party contract is used, the CLT can agree to assign its purchase option as one of the interdependent conditions of the contract – in which case there may be no need for a separate assignment document.)

It should be noted that the prospective buyer normally makes a deposit against the purchase price when the contract is signed. If the prospective buyer then fails to complete the purchase on the agreed-upon terms, the deposit is normally forfeited (provided that all contingencies have been met). At least in the case of three-party contracts, there should be a clear understanding as to how a forfeited deposit is to be allocated between the CLT and the lessee-homeowner. Presumably the share to be received by each should depend to some degree on the costs that each is expected to incur (perhaps including additional housing costs incurred by a lessee who has to relocate while still making payments on the CLT home).

*Contracts for other types of transactions.* Transactions other than the two types discussed above may require that purchase and sale contracts be varied in other ways. For instance,

transactions involving CLT acquisition of land from a third party that is simultaneously selling the improvements to a homebuyer may require either *two* contracts (one between the third party and the homebuyer; another between the third party and the CLT) or a single *three-party* contract. In any case, what is important is that there be clear written agreement(s) as to who will transfer what to whom on what conditions.

### **Preparation for the Closing**

**The need for careful, timely preparation and review of documents.** Typically, a number of documents must be signed to accomplish all aspects of the closing. In preparing for the closing, the CLT and its attorney must make sure that all of these documents say what they are supposed to say. This may sound like an easy matter, but serious mistakes are easily made.

Consider, for instance, how easily a deed may be prepared that conveys *land and improvements* when the CLT's intention is to convey only the improvements. Like other legal documents, deeds are normally prepared with a word processor by modifying an electronic template as necessary for the particular transaction. Every law firm has such templates within its computer system. Routine documents are then typically prepared by legal assistants or legal secretaries who modify the appropriate template according to certain instructions. If these instructions are not fully communicated and understood, or if the person preparing a deed for a CLT transaction simply forgets to use the CLT version of the template, the result may be that a fee simple interest in the land as well as improvements will be inadvertently transferred. This is of course just one of many possible mistakes that are easily made and that can cause serious problems if not corrected.

Preventing such mistakes requires, first of all, that documents be prepared soon enough so that there will be adequate time for them to be reviewed by CLT personnel and other parties that have a direct interest in seeing that the documents say exactly what they are supposed to say. In any case, it is critical that documents be carefully checked, prior to the closing, by personnel who have a full understanding of the kind of CLT transaction that is to take place. It is ultimately the CLT's responsibility to see that the CLT approach to ownership is faithfully implemented through the transactions it carries out.

**Specific points to check *prior* to closing.** The following is a list of some of the more important *CLT-specific* points to check before it is time for the great flurry of document-signing that is the closing.

1. The deed for the improvements being sold to the homebuyer must contain an accurate description of the property being transferred, specifically limited to "improvements only."
2. The lessee-homebuyer's mortgage documents must contain an accurate description of the property being mortgaged, specifically limited to the improvements and the leasehold interest – or the leasehold interest *including* the improvements (or leasehold estate including improvements).
3. All other terms and provisions of mortgage documents – and the terms and conditions of any ground lease rider that the lender may require – must be read, understood and accepted by CLT personnel. The 2011 Model Lease stipulates that by signing a ground lease for the homebuyer, the CLT approves the mortgage loan with which the home is being purchased. If the CLT lease is based on an earlier version of the Model,

requiring the CLT's written approval of the mortgage (and if this written approval is not provided through the CLT's signing of a lease rider), then a separate approval document must be prepared and signed. (For more on this matter, see Model Lease, Article 8, and the accompanying commentary; also Chapter 20, "Financing CLT Homes.")

4. Any documents relating to deferred loans to the homebuyer (secured by subordinate mortgages on improvements and leasehold interest) must *not* provide for forgiveness of debt over time (assuming the CLT has reached agreement in principle on this matter with the funder). It should be noted that the conventional documents used by funders in making deferred loans to *non-CLT* homebuyers *do* often provide that the debt is to be forgiven over time. CLTs must make sure that such documents are modified for CLT transactions. (See Chapter 19, "Subsidy Structure," for more on this matter.)
5. The ground lease must be complete and accurate, with all necessary attachments. All information that is specific to the particular transaction – e.g., lessee's name and address and the description of the parcel being leased – must be accurately incorporated in the document.
6. A "memorandum of lease" (also called "notice of lease" or "short form lease") must also be complete and accurate, must be in a recordable form, and must be consistent with the requirements for this document as stated in the ground lease itself (see Model Ground Lease, Section 14.12).

### **At the Closing and Afterward**

**Preparation and oversight.** Closings may be overseen in either of two ways, depending on the state in which they take place. In some states it is the attorneys for the parties involved in the transaction (and/or those parties acting for themselves) who are responsible for making sure that all the necessary documents are properly drafted, signed and recorded. In other states, however, this responsibility is assumed by title companies.

When the closing is to be overseen by a title company, closing instructions must be prepared by a mutually agreeable party and delivered to the title company. In conventional real estate transactions, where the fee simple interest in the entire property is being transferred, the necessary instructions are relatively routine. It is often the homebuyer's mortgage lender that provides these conventional instructions, but the other parties may provide additional instructions to the title company when there is reason to do so. When a CLT closing is to be overseen by a title company, it is particularly important that CLT staff and/or the CLT's attorney either take an active role in the preparation of closing instructions or review them very carefully to make sure that the correct property interests are being described and/or mortgaged.

**Signatures.** A transaction is completed (closed) by the signing of documents. Some documents (e.g., board resolutions, letters of stipulation) are prerequisites for the transaction and can be signed at any time prior to the closing of the transaction. Other documents (e.g., deeds, ground leases, mortgages) must be signed at the time of the transaction, since it is the signing of them that effects the transfer of property interests. It is critical that all necessary documents be signed by the appropriate authorized people.

- Deeds must be signed by the designated representative of the party transferring the property (e.g., by the Board-authorized CLT representative if the CLT is selling the improvements to a homebuyer).
- Deeds must be signed by the designated representative of the party transferring the property (e.g., by the Board-authorized CLT representative if the CLT is selling the improvements to a homebuyer).
- Mortgages or deeds of trust are signed only by the mortgagors (borrowers), who are mortgaging property that they own or are in the process of acquiring. (Technically, they cannot mortgage the property until they do own it. In practice what is important is that the deed transferring title to the homebuyers be *recorded* before the mortgage or deed of trust on that property.) Mortgage riders must also be signed by the mortgagors. However, agreements in which mortgage lenders agree to special conditions, such as the requirements for a “standard permitted mortgage,” should be signed by the lender (and by the CLT and/or homebuyer if they, too, agree to conditions stated in the document).
- Ground leases must be signed by *both* the lessor and the lessee (the CLT and the homeowner ). Two originals should be signed, one to be held by each party. Ground lease riders must also be signed by both the lessor and the lessee.
- Recordable memorandums of lease must be signed by both lessor and lessee.

**Cash flow.** Money (monetary value in one form or another) comes to the closing from multiple sources and is divided and credited to multiple parties (potentially including attorneys, title company, the public office that records deeds, mortgages, etc., collectors of property taxes and transfer taxes, lenders that have provided loans to the CLT for acquisition and development or lenders that have provided mortgage loans to the selling homeowner, as well as the CLT itself). The arithmetic can be confusing for the unprepared. The CLT representative should be prepared with a complete record of how the money is to flow – and in particular how much, if any, is to flow to the CLT. At the closing, the CLT representative should make sure that the CLT does receive whatever amount is due it.

**“Document flow.”** Documents also originate with various parties and will become the property of various parties. The CLT representative should have a complete understanding of how the paper must flow from the closing. Signed deeds, mortgages and memorandums of leases are normally taken from the closing by either attorneys or the title company, who will have them recorded in the proper order and then returned to the proper parties. The CLT should normally be sure that it receives one of the signed original copies of the ground lease (the lessee should receive the other signed original), together with any riders or other agreements in which a party has agreed to provisions affecting the interests of the CLT. The CLT should also make sure that it has, for its records, accurate copies (not necessarily originals) of all other documents involved in or affecting the closing.

### **Sample Check List of Tasks in Preparing for and Completing CLT Transactions**

Not all tasks in this list will be necessary or appropriate for all transactions or in all jurisdictions, and some circumstances may call for additional tasks not listed here. Each CLT

should modify the list to address the requirements of its own types of transactions in its own jurisdiction.

- The appropriate parties sign a purchase and sale contract. Each party to the contract receives a signed original. Copies are made and distributed to the attorneys or title company that will oversee the closing. If the contract is signed prior to authorization of the transaction by the CLT Board, then the contract should state that the sale is contingent on such authorization.
- The CLT board passes any resolution required by its policies to authorize the transaction and authorizes one or more representatives to complete it. The CLT Secretary signs a copy of the resolution, certifying that it was duly adopted by the board. When the CLT itself is transferring the fee interest in the improvements and a leasehold interest in the land to a homebuyer, the resolution should authorize the transfer of both interests. When the CLT is not the seller of the improvements but is assigning its option to buy the improvements and is either agreeing to an assignment of the leasehold interest or is agreeing to sign a new lease, the resolution should authorize the specific actions intended.
- Closing documents, normally including the ground lease and deed to the improvements, are drafted, based on the contract.
- When the CLT is to assign its purchase option to a new homebuyer, a written assignment-of-purchase-option is prepared, unless the assignment is accomplished within a more comprehensive agreement (such as a three-party purchase and sale contract).
- The CLT circulates documents for review by the homebuyer and/or other participants in the transaction. These documents typically include the ground lease with exhibits and associated documents, any grant or deferred loan documents obligating the homebuyer, and any homeowner association documents.
- The homebuyer reviews documents and consults with her attorney. She may ask questions of the CLT regarding the documents. If she is satisfied, she gives letters of stipulation and acknowledgment to the CLT (within the required time period if a time limit is stated as a contingency in the purchase and sale contract).
- The CLT gets a copy of the homebuyer's loan application package and proposed mortgage or deed of trust documents from the lender or homebuyer. The CLT reviews mortgage terms to make sure that they are consistent with the CLT's policies.
- The CLT makes sure that household income information in the application package is consistent with the CLT's records and the requirements associated with any subsidies involved in the deal. The CLT also makes sure that, at the time of the scheduled closing, the income documentation will be as recent as is required by funders and mortgage lenders.
- The CLT gets a "certificate of corporate good standing" and/or any other certifications that are prerequisites for closing in the particular jurisdiction.

- Closing instructions are prepared by CLT attorney and/or staff, covering distribution of the sales proceeds, documents to be executed, and stating which documents are to be recorded after the closing.
- The CLT makes sure that all funds (from all sources) necessary to complete the closing are or will be available and can be transferred at the closing.
- At the closing, the CLT attorney and/or designated representative make sure that all necessary documents are properly executed, and all monies properly allocated.
- After the closing, the CLT makes sure that all necessary bookkeeping entries are made to account for all consequences of the transaction. These entries will relate not only to cash receipts or disbursements but to the acquisition or transfer of non-cash assets and the assumption or discharge of liabilities.
- The CLT makes sure that all necessary documents are received, after having been recorded, and that they are properly and securely filed.

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<sup>1</sup> In some contexts, the term “leasehold estate” is used to refer to the *combined* ownership of the leasehold interest in the land *and* the fee interest in the improvements (i.e., the combined property of the lessee), but this usage is not universal. In this chapter we avoid the use of the term “leasehold estate” and refer instead to the “leasehold interest in the land” and the “fee interest in the improvements” as separately identifiable ownership interests held by the CLT homeowner.

## Chapter 23

# CLT Post-Purchase Stewardship

The CLT's post-purchase stewardship function is what distinguishes the CLT model from other affordable homeownership programs. A CLT may or may not build or rehabilitate housing. It may or may not have a major role in training prospective homebuyers and marketing homes. Of necessity, however, a CLT has an essential, ongoing, long-term stewardship role with regard to the owner-occupied homes on its land. Even if at some point it has ceased acquiring property, its commitment to stewarding previously acquired property should not waver. A CLT must be prepared to carry out an effective stewardship program on a truly perpetual basis. Needless to say, such a program, and the means by which it is to be funded even in the absence of other activities, must be carefully planned.

### Basic Stewardship Goals and Necessary Activities

In its stewardship role a CLT has three basic goals:

- to preserve the affordability of its homes, for the intended income level, from one owner to the next – and to see that only income-eligible purchasers benefit from this affordability;
- to see that the owners of those homes are secure – that they are not displaced by foreclosure or other economic events;
- to see that the physical quality of those homes is preserved from one owner to the next.

Much of the time the CLT model is described primarily, if not solely, in terms of the first of these goals, the preservation of affordability, but, in reality, all three goals must be achieved if the CLT is to be a successful long-term steward. It is not enough to see that a home is sold for an affordable price if the low-income buyer lacks the training and support needed to succeed as a homeowner. Nor will an affordable resale price be a real accomplishment for the CLT if the physical quality of the home has deteriorated over time to the point where it is no longer a desirable place to live and its affordable price is no longer a bargain.

It is also true that much of the time the CLT's stewardship function is described primarily as a matter of *enforcing* the requirements and restrictions that are written into the CLT ground lease. Certainly the ultimate legal enforceability of the lease provisions is an important concern for CLTs, but, in practice, legal enforcement as such is a last resort. Most of the work of stewardship consists of the day-to-day, year-to-year activities that are necessary to see that the requirements and restrictions are willingly observed without resorting to legal compulsion. This chapter will focus on these ongoing activities. For discussion of the kinds of legal enforcement processes that may be required if all else fails, see Chapter 24, "Dealing with Worst Cases."

In general, day-to-day, year-to-year activities fall into the following four categories.

- *Disclosure*: making sure that homeowners are given all the information necessary to understand their obligations and opportunities as lessee-homeowners.

- *Monitoring*: making sure that the CLT has adequate information about the homeowner's compliance with obligations and about her success as a homeowner.
- *Support*: helping homeowners succeed, through training, direct assistance when possible, or through referrals to other sources of help.
- *Approval*: reviewing all situations where a homeowner wants to take actions for which CLT's approval is required, and deciding what is fair and appropriate.

We will review each of these categories in turn, but first let us emphasize something that is an important dimension of all of these activities: personal *engagement* between CLT and homeowners. All of these activities will be easier to accomplish, more effective, and possibly more economical, when carried out in situations where homeowners are actively involved with the organization and have positive relationships with staff and others in the organization. More than anything else, it is this kind of engagement that will prevent stewardship from becoming something that necessitates legal enforcement.

## **Disclosure**

CLT homeowners must be fully informed about – and must fully understand – the special requirements and restrictions that distinguish CLT homeownership from traditional homeownership. The CLT must be sure both that homebuyers are fully informed before they purchase CLT homes and that their understanding remains clear and accurate and is not allowed to fade over time.

The subject of introducing prospective homebuyers to the CLT approach to ownership is addressed in Chapter 21, “Marketing, Buyer Assistance, Buyer Selection.” Chapter 22, “CLT Real Estate Transactions,” then addresses the process of making sure that those who do actually purchase CLT homes fully understand the nature of the ownership rights and obligations that they are acquiring. An important part of this process is the required “Letter of Agreement” (aka “Letter of Stipulation”) in which the homebuyer's understanding of the terms of the lease – and in particular the terms that limit her ownership rights – is summarized in non-technical language. The letter, referenced in Article 1 of the Model Lease, is signed by the homeowner and attached to the lease as an exhibit. Each new lessee-homeowner – including those who acquire the home and leasehold interest as heirs – must sign such a letter. Article 1 of the Model Lease also requires the attachment of a letter signed by the homebuyer's attorney (the “Letter of Attorney's Acknowledgement”) stating that the attorney has reviewed the terms of the lease with the homebuyer. Although full responsibility for disclosing all aspects of the “CLT ownership arrangement” rests with the CLT, it is important that homebuyers also receive an independent description of that arrangement from an attorney as an objective third party qualified to understand the terms of the ground lease.

The nature of CLT resale formulas, which limit the amount for which the homeowner is allowed to sell the home, involves particular disclosure concerns for the CLT. The formula can have major financial consequences for the homeowner, and some such formulas are relatively complicated in their details. Issues relating to the CLT homebuyer-homeowner's understanding of various specific resale formulas are discussed in Chapter 12, “Resale Formula Design.”

Important as it is for CLT homeowners to understand the exact nature of CLT ownership *before* they purchase a CLT home, there remains a need for *continuing* disclosure as well. The fact that a CLT homeowner focuses on and understands the terms and conditions of the CLT lease and related documents at the time of purchase does not mean that she or he will retain a clear understanding of these details years – and perhaps decades – after the time of purchase. The CLT will need to make sure that homeowners are reminded from time to time of the ways in which their rights and obligations differ from those of conventional homeowners. Like so many other aspects of CLT stewardship, this is more easily accomplished in the context of ongoing, positive, two-way communication between the individual and the organization.

In particular the CLT should establish a system for periodically reviewing and reporting to homeowners the effect of the resale formula on the potential resale price of each home. For some resale formulas (“fixed-rate” and “indexed” formulas) the CLT can simply apply the appropriate factor to the “base price” for each home to determine what the actual maximum price would be if the home were sold at that time. For “appraisal-based” formulas it is not possible to determine the actual maximum price without an appraisal, but CLTs that use appraisal-based formulas should still periodically remind homeowners of *how* the maximum price would be determined if they intended to sell at the time.

Finally, it should be emphasized that disclosure is important not only with those to whom the CLT initially sells a home but also with all those who may later acquire the home – including both those who may purchase the home directly from the preceding owner and those who may be heirs of the preceding owner. With both types of succeeding acquisition, the CLT will need to be sure that the prospective new owner understands the nature of CLT ownership, has signed a “letter of agreement” and has consulted with an attorney who has signed a “letter of attorney’s acknowledgement.”

## **Monitoring**

By one means or another the CLT must keep itself adequately informed regarding certain aspects of the performance and status of its homeowners. It must know whether the homeowner is in compliance with the basic requirements established by the CLT Lease, by the homeowner’s mortgage, and by local laws and regulations. And, more generally, it should be aware of any problems in the homeowner’s life that may affect her security as a homeowner.

The means used by the CLT to monitor such matters may vary from one CLT program to another depending on the type of program and the character and geographical extent of the community that it serves, and, again, depending on the CLT’s relationship with the homeowner. For a CLT working in an urban neighborhood (or other relatively small area) with a limited number of homeowners, much of the monitoring that is needed may be a relatively simple matter of observing what is happening with particular homes in the neighborhood, listening to the owners of those homes, and perhaps also paying attention to what the CLT’s homeowner-members know about each other’s lives. On the other hand, for a CLT operating in a large geographical area with a large number of widely scattered homeowners, other means of monitoring – and other ways of promoting engagement with the homeowner – are likely to be more important, with the particular means depending on the aspect of performance being monitored.

We will review here the more important aspects of homeowner performance that should be monitored, and the means commonly used for monitoring each. Some of these aspects will be also be discussed below, under the heading of “Support,” in connection with the ways the CLT may be able to assist the homeowner in dealing with them. We will look first at aspects relating to financial circumstances, then at those relating to the occupancy, use, and physical condition of the homes, and finally those relating to transfers of ownership.

**Monitoring financial activity.** The CLT must be sure that the homeowner is paying those costs for which she is responsible. The CLT must also be sure that the homeowner does not take on additional financial commitments that may threaten either her financial security or the future affordability of the home for others.

*Lease fee payments.* The possibility that a homeowner may fail to make regular monthly lease fee payments is a significant concern not only because such failure deprives the CLT of revenue but also because it may be a first warning that the homeowner is struggling financially and because, in any case, it can lead to serious difficulties if not addressed soon enough. (The problem is even greater if the cost of taxes on the land is being passed on to the homeowner as part of the lease fee. In this case, if lease fees have not been paid when taxes are due, the CLT may have to advance the necessary funds while seeking eventually to collect from the homeowner.)

It is not difficult for a CLT to monitor lease fee payments (as long as the fee is to be paid directly to the CLT). However, if a CLT fails to deal clearly and decisively with violations of this basic financial obligation, some homeowners will develop the habit of repeated nonpayment, with the result that their debt to the CLT will continue to mount to the point where they are unable to pay it. At that point the CLT may have no alternative but to take legal action in order to collect what is owed to it (see Chapter 24 regarding methods of dealing in with this kind of “worst case”). Even if the CLT is eventually successful in collecting the debt, however, the situation will have taken on an adversarial character that will make the CLT’s role as steward more difficult on all fronts.

It is therefore important to deal with nonpayment promptly, methodically, and constructively. The method that will be followed should be disclosed to all and should be the same for all of the organization’s homeowners, month in and month out. The 2011 version of the model lease provides for interest to be charged on missed payments from the date the payment is due but also provides for interest to be waived if the payment is received within 30 days of the due date. With these provisions in place, the CLT should send a formal notice to anyone who has not made the payment in a specified number of days (e.g., 10 days) after the due date. The notice should remind the homeowner that the payment is due, and that interest is accruing and will be payable *if* the fee is not paid within the specified period, but it should also invite the homeowner to call and discuss the situation if for some reason she will not be able to make the payment within that time period. If the homeowner does not respond and does not pay before the 30-day period expires, another notice should be sent, showing the amount then due (the past month’s fee plus interest, plus the current month’s fee). If there is still no response, it is probably time for a proactive effort to contact the person, express concern about the situation, and offer to help find a solution if the homeowner is in fact experiencing financial difficulties (see “Support” below).

In any case it is important to continue to send monthly statements showing the total amount owed. If some arrangement has been made to defer or restructure the debt, that fact should be reflected in the statement. But the statements should still be sent regularly – the homeowner should never be given the impression that the CLT has forgotten or has decided that payment is not important after all.

*Mortgage payments.* A homeowner's failure to make mortgage payments can of course threaten both the homeowner's security and the CLT's long-term control of the affordability of the home. The question is: by what means can the CLT learn of this problem before it is too late. If possible, the CLT should get the mortgagee to agree to notify it in the event of nonpayment (see Chapter 20, "Financing CLT Homes"). However, even when such an agreement is in place, the mortgagee or servicer of the loan may not send a notice of default (either to the homeowner or the CLT) until the homeowner is so deeply in arrears that the problem may be too large to solve even with the CLT's help. The CLT is much more likely to be able to help if it is personally engaged with the homeowner in the kind of relationship that will result in the homeowner sharing the problem with the CLT when there is still enough time to work out a solution. All homeowners should know that the CLT *wants to know* if they are having trouble keeping up with mortgage payments and *wants to help* deal with the problem.

*Tax payments.* The homeowner's property taxes are often collected by the homeowner's mortgagee (or by the servicer of the loan) as part of regular monthly payments that also include principal, interest and insurance costs. The tax payments are escrowed and paid to the tax authority when the annual amount is due. As long as a CLT knows that taxes on *both land and improvements* are being handled in this way, there is no need for the CLT to monitor tax payments separately, but the monitoring of mortgage payment becomes all the more important in this case. See Chapter 13, "Establishing and Collecting Fees," regarding the different ways that CLTs have dealt with the payment of taxes on the land as distinct from taxes on the home (the improvements). See also Article 6 of the Model Lease together with the commentary on Article 6.

*Payment of insurance premiums.* Article 9 of the Model Lease obligates the homeowner to keep the home insured against loss or damage by fire, etc. and to maintain liability insurance covering the home and leased land. As in the case of property taxes, insurance costs are often collected in monthly increments by the mortgagee that has an obvious interest in seeing that insurance on the mortgaged property is continued without interruption. The CLT must be able to confirm that the full amount of coverage required by the lease is in fact being maintained in this way. If it is not being maintained in this way, the CLT must seek direct confirmation from the homeowner that the required premiums are paid (see commentary on Model Lease, Article 9).

*New or additional mortgage financing.* The refinancing of a CLT home (replacing an existing first mortgage with a new first mortgage on different terms and/or for a different principal amount) can provide important advantages for a CLT homeowner, but it can also entail serious risks for both the homeowner and the CLT. As is true of the homeowner's initial mortgage financing, any new or additional mortgage loans that the homeowner may want to secure must be approved by the CLT. The CLT's first concern, however, is to be sure that both the homeowner and the potential lender are aware of this requirement and will contact the CLT before proceeding to close any new loan. The requirement should of course be fully disclosed to the homebuyer prior to purchase, but,

as noted above in the discussion of disclosure issues, a homeowner's understanding of such a requirement is likely to become hazy over time and may not prevent her from moving forward on her own – particularly if loan products are being aggressively marketed to her by a lender who is less than diligent in researching the title to her home. It has been surprisingly common for such lenders not only to remain ignorant of the specific ground lease requirements regarding new or additional financing but to remain ignorant of the existence of the ground lease altogether. As with the monitoring of other activities, the best way for the CLT to be sure that it will be informed that new or additional financing is being considered is to maintain active communication with all homeowners and to remind them from time to time that the CLT must approve any new mortgage financing – and perhaps to suggest that if they are considering new or different financing the CLT may be able to help them arrange appropriate terms.

In those cases where new or additional mortgage loans are actually closed without the CLT's knowledge, the monitoring concern is a matter of discovering that this has happened so that the CLT can address the matter with the mortgagee. The CLT may eventually learn what has happened from the homeowner herself, but this is less likely in the case of programs where CLT homes are widely scattered and the CLT's engagement with homeowners is limited. In such case, a CLT may establish procedures for periodic review of the titles of all homes in its portfolio to determine whether additional mortgage liens have been filed.

*Other liens.* If a homeowner has allowed liens to be filed against the home by a tradesperson or other party whom the homeowner has failed to pay for work completed on the home – or perhaps for other services provided such as medical care – it is important for the CLT to know of the existence of the liens, which can affect the resale of the home in ways that can undermine both the homeowner's financial interests and the future affordability of the home. With knowledge of the situation, the CLT can take steps (or help the homeowner to take steps) to get the liens released. Section 7.4 of the Model Lease requires the homeowner to notify the CLT of liens that have not been released within 60 days of filing. The reality, however, is that the homeowner may not be aware that the liens have been filed, or may not understand the consequences of the filing. In this case, a periodic review of titles of all CLT homes, as noted above, may be the only form of monitoring that will give reasonable assurance that the liens will not go unnoticed until the home is eventually offered for resale.

**Monitoring occupancy, use, and physical condition of the home.** In some respects these tangible conditions are easier to monitor than the financial conditions discussed above, simply because they are more directly observable. In other respects, however they involve special problems. There are grey areas where the question of whether a homeowner is in compliance is a matter of interpretation. There are also sensitive areas where monitoring can be perceived as an invasion of the homeowner's privacy.

*Occupancy.* For any program designed to provide affordable homeownership opportunities on an ongoing basis, permanent occupancy of the home by the owner is a necessary requirement. Though permanent occupancy is defined differently by different CLTs (usually as occupancy for from 10 to 11 months of each year), it is required in one form or another by all CLT leases (see Section 4.4 of the Model Lease). If a CLT cannot confirm that an owner is in compliance with the requirement through everyday observation (e.g., observation that her children are regularly in the yard and her car

regularly in the driveway), then another method of monitoring occupancy may be necessary. Regular mailings to all homeowners is one method, though the fact that mail is not returned to the CLT from a homeowner's presumed address is not certain evidence that she is no longer residing there. It should be noted that occupancy by an owner's spouse or child (or other CLT-approved persons) constitutes occupancy by the owner under the terms of most CLT leases – a provision that may sometimes require the CLT to sort out who is who (and who is where) within a household in order to determine whether an owner is in compliance.

*Subleasing practices.* In situations where the CLT *has* approved extended non-occupancy (e.g., so the owner can pursue educational goals in another location for some period of time), the CLT's concern is likely to become a matter of approving and monitoring the terms on which the home is rented to others. See Section 4.5 of the 2011 Model Lease and the commentary on that section. An extended violation of the occupancy requirement is likely to be accompanied by unapproved subleasing. In fact, evidence of extended occupancy by people other than the owner may be the most apparent evidence of such a violation.

*Permitted vs. non-permitted uses of leased land.* Most CLT leases, following Section 4.1 of the Model Lease, limit use of the home and leased land to residential and related purposes – with permissible related activities usually defined by local zoning codes and other local ordinances. Compliance with such codes and ordinances – and the law in general – will normally be monitored more or less closely by local government(s), as well as by the CLT. For both CLT and local government, some use violations will be obvious (e.g., the front room converted to a liquor store, or maybe a goat tethered in the front yard), while others will be hard to observe and perhaps even harder to prove (e.g., drug trade or other illegal activity carried on inside the home). If the CLT suspects that illegal activity is going on behind closed doors, it may sometimes be able to deal with the situation by talking with members of the household and suggesting that they “clean up their act” before law enforcement officials need to be involved. If this approach is not appropriate and effective, then law enforcement officials may in fact need to be involved.

*Physical maintenance of home.* As we have emphasized, preservation of the physical quality of the home is an important aspect of CLT stewardship that in the past has often received too little attention. The process of seeing that maintenance problems are addressed is discussed below under the heading of “Support,” but before such problems can be corrected they must be identified. Some problems can of course be easily identified just by walking past the house and seeing, for instance, that the exterior paint is in bad shape. Other problems can be identified only through an interior inspection. Many, if not most, CLT leases follow the Model Lease in not giving the CLT a right to inspect the interiors of buildings without the homeowner's permission. The most effective inspections, however, will be those that are carried out *with* the homeowner and in connection with maintenance support services.

*Alterations & additions.* Substantial owner-initiated additions to or alterations of the home must be approved by the CLT (see Section 7.3 of the Model Lease) before work is done. If the homeowner does not seek approval, the CLT may still become aware that work is being done on the home. In this case, the CLT should first determine whether approval is or is not required, and then – regardless of whether approval is required –

should ensure that all work complies with lease requirements, building codes, and requirements of applicable insurance policies.

*Damage or destruction.* Homeowners should be encouraged to report any significant fire, water, or storm damage to homes when, or before, they contact their insurance company. In addition, the CLT should maintain a relationship with any insurance agency(s) providing coverage for the homes in its portfolio, and should be sure that the insurers are informed regarding the insurance-related provisions of the lease and that they are aware that the CLT will monitor the processing of claims. In any case, the CLT must see that damage is repaired and insurance proceeds are allocated in accordance with the terms of the lease (see Sections 9.4 & 9.5 of the Model).

**Monitoring transfers of ownership.** CLT leases prohibit any transfer of the home and the homeowner's leasehold interest in the land without the explicit consent of the CLT. The CLT's *first* monitoring concern is therefore a matter of being aware of all potential transfers before they happen. This is usually not a problem: potential transferees should normally *want* to have the CLT's consent, since, without it, they could not gain valid title to the property. The only exception would be people who are aware that they are not eligible transferees but are willing to risk discovery of this fact in order to gain possession of the home. In any case, the CLT's *second* monitoring concern with regard to transfers entails determining the *eligibility* of potential transferees.

*Inheritance.* Section 10.3 of Model Lease requires the executor of the estate of a deceased homeowner to notify the CLT within 90 days of the homeowner's death. If the CLT is already aware of the homeowner's death, it should not delay contacting the executor to determine who the heirs are and whether they want to occupy the home and are eligible to do so. The CLT should also make sure that the executor understands that under the terms of the lease (if it follows the Model Lease) an heir must either (1) be the spouse or child of the deceased owner or someone who has lived in the home for at least a year *or* (2) be income-qualified in the same way a purchaser of the home would be required to be. (It should be noted that subsidy sources often require the modification of the lease provisions regarding who is eligible to assume owner-occupancy of the home: see Chapter 19, "Subsidy Structure.")

Eligible heirs who *do* want to become homeowner-lessees must sign a "letter of agreement" (or "letter of stipulation") and provide a letter of attorney's acknowledgement, as required of all CLT homeowners. If there is *not* an heir who both wants to own the home and is eligible to do so, the home must be sold, in accordance with the CLT's resale provisions, with the seller's proceeds passed on to the heir(s) through the estate. The administration of an estate can involve a variety of complications that can easily take many months to work through. Determining the eligibility of heirs to assume ownership of a CLT home can add to these complications – particularly if the CLT must address questions such as, for instance, whether an heir has or has not lived in the home for at least a year. The CLT should deal with all questions thoroughly, but should not allow the process to drag on any longer than necessary – particularly if the home is sitting empty and subject to possible damage or deterioration.

*Resale.* The CLT's first concern in the case of resale is to be aware that the owner wants to sell, so that it can monitor any of the possible processes through which resale may happen (see Model Lease, Article 10 Sections 10.4 ff) and can ensure that the transfer complies with the requirements of the lease, whether the transfer involves

exercise of the CLT's purchase option or direct sale to a buyer whose eligibility is confirmed by the CLT. Normally the homeowner *will* notify the CLT of her intent to sell as required by the lease. If a homeowner were to try to sell the home without the CLT's knowledge, the effort would probably come to the CLT's attention when an attorney or title company representative acting on behalf of a potential buyer or potential mortgagee discovers that the home is subject to a CLT ground lease with terms that limit resale. As noted above, the only exception would be a direct sale – almost certainly for cash – to someone willing to take the risk of possessing a home to which he or she did not have clear title. Should this actually happen, it is almost inevitable that, sooner or later, it will come to the CLT's attention that an unauthorized party has taken possession of a CLT home. In such case the CLT's only recourse is likely to be legal enforcement of its rights with regard to the property (see Chapter 24, "Dealing with Worst Cases").

The possible roles of the CLT in overseeing the resale process, once notified of an intent to sell, are noted below in terms of the CLT's *support* for the homeowner (e.g. assistance with marketing and preparing the home for sale) and the CLT's *approval* responsibilities (e.g. approval of buyer eligibility and of the home's physical condition).

### **Support for Homeowners**

At the heart of CLT stewardship is the support that CLTs provide to homeowners whose financial resources are limited and who have little or no prior experience in dealing with homeownership issues. This support may include training in certain areas, direct assistance in dealing with certain matters, and referrals to others that can provide specialized training or assistance when needed. The context in which these kinds of support will be most effective is one of personal engagement and trust between the CLT and its homeowners. The fact that a CLT has the *ability* to help its homeowners succeed will mean little if homeowners are not comfortable sharing their problems and accepting assistance or guidance from CLT personnel. A CLT that is seen by its homeowners primarily as a policeman who watches over them in order to enforce compliance with the terms of a complicated legal document will not be able to provide effective support. Nor will a CLT that is less threatening but is remote from its homeowners, with personnel who don't really know who the homeowners are and don't seem to care about their wellbeing.

**Support regarding financial issues.** Many of the financial monitoring issues discussed above relate directly to a homeowner's success in managing household finances. Failure to make lease fee payments or mortgage payments, failure to deal with tax or insurance obligations, failure to prevent liens from being filed against the home as a result of unpaid debts – all of these are indications either that household finances are being poorly managed or that the homeowner has suffered a financial setback that makes management particularly difficult. Whatever the cause, situations in which lower income homeowners are falling behind in meeting financial obligations are likely to get progressively worse if the homeowners are left to their own devices – or left to fall prey to predatory lenders offering financial "solutions" that will turn a potentially manageable problem into something completely unmanageable.

The first line of assistance that a CLT can provide is basic financial management training for all new homeowners, perhaps as a requirement for purchase, either by CLT staff or through other specialized programs to which homebuyers can be referred. More

specialized financial management – or credit management – training may also be offered to homeowners when there is an indication that it is needed.

In any case the CLT should engage with homeowners at the first signs of financial difficulty – before problems have snowballed – to determine the cause or causes of the problems. Has the homeowner yielded to the temptation to overuse available credit card credit, or to purchase a new car with a loan that has stretched her ability to meet total debt service obligations? Or have household expenses risen as a result of accident or illness within the household, or the need for major repairs within the home, or through efforts to help members of the homeowner’s extended family with crises in their own households, or as a result of increased tax assessments that jack up monthly housing costs? Or has household income been suddenly reduced by loss of a job, or unpaid maternity leave, or separation or divorce and/or the departure of another wage earner from the household?

Depending on the answers to these questions a CLT may be able to help in a variety of ways, including the following.

- Credit counseling, through the CLT or other agency, to help manage and restructure debt.
- Intercession to negotiate with creditors to restructure debt.
- Assistance in negotiating new property tax assessment with the local tax jurisdiction (see Chapter 17, “Property Tax Assessments”).
- Temporary reduction or waiver of lease fee, or development of alternative repayment schedule for accumulated debt to the CLT.
- Arranging or facilitating financing or refinancing from alternative sources (including the CLT itself, nonprofit loan programs, credit unions) on terms that are fair and affordable.
- Referrals to government programs that may help with home repair and other costs.
- Referrals to sources of appropriate, affordable legal assistance.

When a homeowner’s financial problems involve substantial arrearage on mortgage payments, the threat to the homeowner’s security – as well as the threat to the CLT’s ability to preserve the affordability of the home – is heightened. The CLT must work with the homeowner to determine whether it will be possible for her to catch up with payments and avoid formal default. If a formal notice of default has already been issued, the question will be whether the default can be cured within the period of time allowed for a cure. If the homeowner does not have the capacity to cure the default within the time allowed, the question will be whether the CLT is prepared to cure the default on the owner’s behalf (treating the payment as a loan to the homeowner, who should sign a note with an agreed-upon repayment schedule). Normally, a CLT should take this action only if it can be reasonably confident that the homeowner will be able to repay the loan while also keeping up with other ongoing debt service obligations.

If it does not appear possible for the homeowner either to cure the default or to repay a loan from the CLT while remaining current on other obligations, the CLT’s efforts should shift to helping the homeowner to avoid foreclosure and recover some equity by selling the home. If the home is in reasonably good condition and the CLT has a waiting list of qualified homebuyers, it should be possible to move expeditiously to sell the home in such a situation. If a little more time is needed to complete the transaction, the

mortgagee will have every reason to grant the additional time so that the mortgage debt can be paid from the proceeds of sale without the cost entailed by foreclosure. The homeowner must of course agree to sell the home in this situation – which some owners may not do, even though it is clearly in their interest. They may cling to the hope that somehow they will find the money to cure the default and so will resist the loss of their home to the bitter end. Or it may be that estranged co-owners will not agree to sell because they are having a hard time agreeing on *anything*. (It is possible, at least in some jurisdictions, for a CLT lease to treat a mortgage default as a default also under the terms of the lease and to treat a lease default as grounds for exercising the CLT’s purchase option – making it possible to sell the home even if the owners have not agree to sell; however most CLT leases do not provide for this.)

If foreclosure cannot be avoided, the CLT must then concern itself with regaining control of the home’s affordability by exercising an option to purchase following foreclosure – if it determines that this move would be cost-effective (see Chapter 20, “Financing CLT Homes”). If it cannot purchase the home for a workable price and if the resale restrictions are then removed from the lease, as would normally be the case, the CLT’s final concern will be to increase the lease fee charged to the new owner to a market rate ground rent (see Section 5.6 of the Model Lease).

**Support regarding home maintenance, repairs, improvements.** As we have said, preserving the physical quality of homes is an important, unavoidable stewardship concern for CLTs, and like other aspects of CLT stewardship it is a concern best addressed through homeowner-CLT partnerships based on trust. If a homeowner sees the CLT as a friendly source of advice and assistance, the CLT will almost certainly have opportunities to influence the physical condition of the home over time. If the homeowner sees the CLT as a stern inspector who comes around periodically to criticize the condition of the home, such opportunities will be limited at best.

*Maintenance.* Maintenance – as distinct from major repairs and improvements – is a matter of doing a number of small things when they need to be done to avoid the need for major efforts later on. Usually the cost of maintenance tasks is not a major factor, and usually a person does not need highly developed skills to complete these tasks successfully. Nonetheless, many of these tasks do require a certain amount of knowledge about how to deal with everyday physical issues in the home – tasks such as replacing filters in a heating or water system, fixing a leaky faucet or clearing a clogged trap in the sink drain. First-time homeowners will not necessarily have this knowledge. In fact they may not even be aware that there are filters that need to be replaced or that it may be quite possible to fix a leaky faucet or clear a sink drain without calling a plumber. Some CLTs have developed basic home maintenance trainings that have proven popular and useful. Some have also established “tool libraries” so that homeowners can borrow the tools they need to complete maintenance tasks.

As noted above in connection with monitoring, most CLT leases give the CLT a right to inspect only the leased land and the exteriors of buildings but not the interiors of homes without the owner’s permission. However, CLTs can provide an important service to homeowners by inspecting both the exteriors and the interiors of homes *with* the homeowners. They can then recommend maintenance and repair activities based on problems observed and what the homeowners have to say about the problems and what they have or have not been doing about the problems. This is yet another area where a

relatively close relationship between homeowners and CLT can greatly facilitate stewardship activities.

*Repairs and replacements.* It is inevitable that certain major repairs or replacements will eventually be needed in any home. Exterior surfaces will need to be repainted; deteriorated roofing will need to be replaced; major components of heating systems will need to be replaced; major appliances will need to be replaced. These are not needs that can be addressed simply by taking a wrench to a sink drain. These are needs where cost is a major factor. The amount of cost – perhaps measured in thousands of dollars – can easily exceed the financial capacity of lower income homeowners. The question of how such costs are to be covered is a major concern for CLTs, but one that, in the past, was often subordinated to an overriding concern with preserving affordability. Today, more CLTs are developing systematic ways of dealing with the long-term need for financing for major repairs, and it is highly recommended that all CLTs address the need directly.

The most direct approach to the matter entails a “repair reserve,” usually funded by an addition to or component of the monthly lease fee, so that, as elements of the home are being worn out or used up, money is being set aside regularly to cover the cost of their eventual repair or replacement. The question of how to structure and administer such a reserve, and how to establish guidelines for its use, involves a number of potentially complicated considerations. A CLT’s approach may depend in part on the age and type of housing the CLT is dealing with. A CLT that is developing new homes in new subdivisions may have reason to adopt policies different from those of a CLT that is doing scattered-site acquisition-rehab projects in older neighborhoods. (And a CLT that is working with condominium projects will be concerned with repair reserves primarily in terms of the condominium’s own *internal* reserve fund.) In any case, CLT experience with repair reserves remains somewhat limited at this time. The 2011 Model Lease includes provisions for a repair reserve (Section 7.6) and for a component of the monthly lease fee that is dedicated as a “repair reserve fee” (Section 5.1). But no model structure or model policies are provided. The various considerations involved in designing such a structure and such policies are discussed in the Commentary on Section 7.6 of the Model.

Another approach to funding major repairs is to make appropriate, affordable financing for home repairs available to homeowners – through a loan fund established within the CLT itself or perhaps through a home-repair loan program operated by a separate community development financial institution (CDFI). A solid working relationship with such a CDFI can be very helpful to a CLT and its homeowners in meeting this and other needs for capital.

Finally, regardless of its approach to funding major repairs, a CLT can provide important support to homeowners by maintaining lists of building trades people – plumbers, electricians, HVAC specialists, carpenters, roofers – who are known to provide objective, knowledgeable estimates and to do good work at reasonable rates. A CLT may save homeowners substantial costs – and may substantially improve the quality and durability of the homes – by helping homeowners to find the right contractors for replacement/repair projects (and by making sure that they avoid fly-by-night contractors who would exploit the inexperience of lower-income homeowners).

*Improvements.* CLTs have two kinds of stewardship concerns relating to improvements – by which we mean alterations or additions to a home that add capacity and value beyond what originally existed. The *first* concern is a matter of seeing that

improvements are appropriate for the site, comply with applicable codes, do not compromise the structural integrity of the house, are well constructed and durable and will have lasting value for succeeding owners (as opposed to just serving some specialized or idiosyncratic purpose of the present owner). As noted below, some improvements will require the CLT's prior approval. Others may not require approval, but the CLT still has the a basic stewardship interest in seeing that these improvements are appropriately designed and professionally executed. To the extent that the homeowner has a positive relationship with the CLT, it will be possible for improvements to be planned in partnership with the CLT and to benefit from the CLT's knowledge of development issues and local contractors.

The CLT's *second* stewardship concern relating to improvements is a matter of preserving the affordability of the home. This concern comes into play explicitly for CLTs using resale formulas that include the possibility of "capital improvement credits" for certain major improvements added by the homeowner (see Chapter 12, "Resale Formula Design"). With improvements for which capital improvement credits are to be awarded, the usual practice is to require pre-approval of both the design and the anticipated added value – as noted in the discussion of *approvals* below.

## **Approvals**

In our review of monitoring and support issues, we have already noted a number of homeowner actions that require the written consent or approval of the CLT. In this section we provide a check list of those provisions of the Model Lease where approval is specifically required. The commentary on the specified sections of the Model can be consulted for more detail regarding the issues in question.

## **Occupancy and use**

- *Extended non-occupancy* (Section 4.4). Approval is required for non-occupancy by the owner (or, in the owner's absence, by a spouse or child of the owner).
- *Subleasing* (Section 4.5). Permission is required for any sublease, and approval of the terms of the sublease is required – the goal being to ensure that the homeowner can recover her costs of ownership but cannot reap undue profits.
- *Uses not permitted by lease but permitted by then-current zoning* (Section 2.1). Approval is not specifically mentioned in this section, but a CLT may agree to permit certain uses not originally permitted by the lease if zoning ordinances permit them.
- *Removal of any part of home* from the leased land (Section 7.1). The basic stewardship principal that the value of the home should be preserved normally dictates that no part of the home should be removed. But exceptions may be approved in the case of improvements that owners have made themselves and want to take with them.
- *Alterations or additions* for which approval is required (Section 7.3). See discussion of support regarding improvements above.
- *Removal of minerals* from leased land (Section 2.2). Removal of minerals is generally prohibited, but a rural CLT might consent, for instance, to the removal of gravel from one part of the land for use on another part. (Also note that the

CLT itself is required to get the *homeowner's* consent to remove any minerals from the land.)

### **Financial Matters**

- *Reduction or suspension of lease fee* to improve affordability (Section 5.4). Such approval is one of the actions that a CLT can take to help a homeowner deal with financial problems.
- *Use of repair reserve* to pay for particular repairs (Section 7.6) – depending on the existence of such a fund and the particular policies established for its use. See the commentary on Section 7.6 of the Model regarding the various possible approaches to the use of a repair reserve fund.
- *Reduction in insurance coverage* (Section 9.4). It's not likely that a homeowner would ask for or that a CLT would want to approve a reduction in coverage, but the homeowner cannot reduce the coverage *without* the CLT's approval.
- *Refinancing or additional mortgage financing* (Section 8.3). It is an important stewardship concern for the CLT to approve the amount, terms and resulting CLTV for any such financing.
- *Capital improvement credit* (if the resale formula stated in Article 10 includes such a credit). Pre-approval of proposed plans and potential amount of credit is normally required. Re-approval after completion of work is also normally required.

### **Transfers**

- *Approval of heir(s)* as qualified transferees (Section 10.3). The process includes acceptance of a letter of agreement and a letter of attorney's acknowledgement.)
- *Approval of direct sale to income-qualified buyer* (if permitted as in Section 10.6 of Version 2 of Article 10). The process includes verification of income qualification and acceptance of letters of agreement and attorney's acknowledgement.
- *Permission for seller to pay cost of necessary repairs out of proceeds of sale* (if the Lease allows this practice, as in Section 10.13 or 10.14 depending on which version of Article 10 is used).
- *Approval of buyer's mortgage* (Section 8.2). Under the terms of the current version of this section of Article 8, the CLT registers its approval of the financing by signing the lease.

### **Covering Stewardship Costs**

The range of stewardship activities described in this chapter – particularly the monitoring and support activities and all of the tasks involved in overseeing and facilitating resales – obviously entail substantial costs, year after year. Funding these activities, along with other aspects of CLT operation, is an abiding concern of all CLTs. Chapter 27, “Planning for Long-Term Sustainability,” provides a comprehensive discussion of the over-all challenge of funding ongoing CLT operations. Here we will summarize basic considerations involved in planning for the support of future stewardship activities – perhaps during periods of time when the CLT is no longer adding to its portfolio of homes and therefore cannot count on the kinds of external support that

can be generated by the *creation* of permanently affordable homes. A CLT in this situation will not have access to development fees. Nor is it likely to have access to the kind of private grant funding that is typically targeted to the creation and expansion of community-based organizations. And it cannot expect to have access to the kind of operating support that government entities may provide for programs that are actively expanding the supply of affordable housing. As a practical matter, a CLT in this situation will need to rely on “portfolio revenue” – primarily lease fees and transfer fees, since these sources are built into the stewardship program and do not call for the additional layer of effort required to solicit other forms of support.

**Monthly lease fees.** The monthly lease fee can be seen specifically as financial compensation for the CLT’s stewardship work (see Chapter 13, “Establishing and Collecting Fees”). Revenue from this source is limited by the necessity of keeping the monthly amount affordable; however, the monthly amount can be increased to the extent that a household’s other monthly housing costs – mortgage principal and interest, taxes and insurance – do not already demand all that the household can afford. In other words, the CLT can maximize the opportunity for lease fee revenue by doing what it can to limit the other monthly costs. These other costs depend in part on variables that are beyond a CLT’s control; nonetheless, there are certain ways that the CLT can influence them.

The CLT can limit the amount of mortgage debt that its homeowners must service by seeking deeper subsidies from public sources. Public subsidy sources are typically eager to get as many units as possible from the available funds, which means putting only as many dollars into each unit as is absolutely necessary to create affordability for the intended income level. CLTs – which are, themselves, typically eager to produce as many affordable units as possible – can be tempted to cooperate with the funder’s subsidy-stretching strategy by keeping their lease fees lower than is really in a CLT’s long-term interest. Generally CLTs should remind their subsidy sources – and themselves – that the work of preserving subsidies entails significant costs and that stretching the available funds too thinly over too many units may not be the best way to support permanent affordability.

CLTs can also expand the long-term opportunity for greater lease fee revenue by adopting pricing policies that create a reasonably wide window of affordability (so that prices are not just barely affordable for the income-qualified households). And CLTs can further expand opportunities for greater lease fee revenue by adopting resale formulas that will tend to increase the effect of the original subsidies and expand the window of affordability when homes are resold. (See Chapter 18, “Project Planning and Pricing.”)

Finally it should be noted that CLTs can influence the homeowner’s property taxes by advocating effectively for tax assessments that are limited to the as-restricted value of CLT property (see Chapter 17, “Property Tax Assessments”).

**Transfer fees.** These fees (sometimes called “lease renewal fees,” among other names) provide an opportunity to fund the sometimes substantial efforts that a CLT must make to see that transfers of ownership are consistent with the requirements of the lease and serve the long-term goal of preserving affordability for income-qualified owner-occupants. Section 10.12 or 10.13 of the Model Lease (the section number depending on which version of Article 10 is used) permits such a fee to be charged to the buyer, as an addition to the resale price paid to the seller. The amount of the fee is usually limited to a specified percentage of the price paid to the seller, and may be reduced from that level to

the extent necessary to preserve affordability for the buyer. The transfer fee is potentially an important source of revenue for the CLT as long as the resale price is affordable *enough* so that the fee can be assessed. Once again, it is in the CLT's interest to adopt policies regarding subsidy-allocation, pricing, and resale formula design that will result in resale prices affordable enough to allow collection of the fee.

**Projecting stewardship costs and income.** A CLT should, periodically, project what its annual operating costs would be in a time when its program consisted entirely of stewardship activities, assuming a given number of units (or several different hypothetical numbers of units). It should then project lease fee and likely transfer fee income based on those numbers of units. To project costs you will of course need to estimate the number of units for which a full-time staff people can cover the necessary stewardship activities. You will also need to address the practical complications that arise when you have just a little more work needing to be done than your one (or more) experienced full-time staff can handle. Projecting annual lease fee income is relatively simple (monthly fee x 12 x number of units minus projected uncollectable fees). Projecting transfer fee income for a specific time period is more difficult since it is impossible to predict when most people will sell their homes. Over the longer term, however, you can project *average* annual transfer fee income if you can establish the average number of years that people own their homes.

If your projections indicate that the organization will not have enough fee income to cover the necessary stewardship costs, you will obviously need to look for ways to increase fees (without compromising affordability), and/or ways to reduce expenses (without compromising stewardship), and/or cost-effective ways to supplement fee income with income from other sources (which, as we have noted, is not as easy for an organization in a holding (or "stasis") phase as for one in a growth phase). Needless to say, the best time to address a projected operating deficit for such a holding phase is earlier in the organization's history, when it is growing and can still make the kinds of policy adjustments discussed above to generate increased fee income for later years.

*A note on economies of scale vs. economies of localization.* It has been suggested that the per-unit cost of stewardship activities will be less for CLTs with large numbers of homes than for CLTs with fewer homes, in the same way that the per-unit cost of rental management is substantially less for large numbers of units than for smaller numbers. No doubt it is true that there are economies of scale for certain activities – e.g. systematic mailings to all homeowners, systematic searches of property records to identify new liens, etc. However, there are other kinds of economic advantages for those smaller CLTs whose holdings are more geographically concentrated, so that many monitoring and support activities can take place through direct observation and face to face consultation, thus reducing the need for systematic "long-distance" activities.

## Chapter 24

# PLANNING FOR SUSTAINABILITY

### The Importance of CLT Sustainability

Community land trusts are typically created in response to unmet needs in the communities in which they operate. Land needs to be kept out of the hands of absentee investors and made available for local residents. Quality housing needs to be produced and preserved. The displacement of residents that all too often results from successful neighborhood revitalization needs to be stemmed. Support services need to be made available for first-time homeowners to enhance their prospects for success. Foreclosed homes need to be placed back on the market in a way that will keep them affordable for lower income people. Neighborhood problems need to be addressed in order to create a stable context for homeownership. And the list goes on. Typically, CLTs respond to such needs with creativity, determination, and a sense of urgency. A CLT's long-term sustainability, however, requires that the organization do more than respond creatively to immediate needs from day to day and year to year. To build and sustain a strong organization requires careful, realistic planning.

By the very nature of its mission, a community land trust commits itself not only to acquiring significant real estate holdings on behalf of a community but also to a set of very long-term responsibilities that are necessarily entailed by those holdings. In this chapter we will discuss the process of building and sustaining both the capacity to acquire significant holdings ("growth capacity") and the capacity to carry out that set of long-term responsibilities ("stewardship capacity"). The two types of capacity are related and both are important, but our primary emphasis here will be stewardship capacity – as a subject that CLTs have a unique obligation to sustain and that often receives too little attention in a CLT's plans.

The long-term responsibilities that distinguish community land trusts from other nonprofit housing organizations include ongoing responsibility to the community for the care of land and housing, an ongoing concern for the wellbeing of the residents of the land and housing (and particularly homeowners), an ongoing responsibility for the preservation of public subsidies, and an ongoing responsibility to the CLT movement as a whole.

**Permanent care of land and housing.** Unlike other developers of affordable *homeownership* opportunities, CLTs do not just sell the homes and then go on to other business; they expect to own the land permanently and accept permanent responsibility for how and by whom it used. And as permanent land-owners they accept responsibility for seeing that housing and other improvements on the land are sold or rented for affordable prices to income-qualified people and are maintained in a condition that will continue to serve the interests of the community.

Unlike most nonprofit *rental* housing organizations, CLTs do not have the option of transferring stewardship responsibilities to another agency. When rental housing *is* developed on CLT land, the CLT may or may not own the housing and may or may not act directly as the property manager, but it does normally expect to own the land permanently, and as land-owner it accepts permanent responsibility for seeing that the property continues to serve the community interests for which it was developed. (In the

case of CLT-initiated rental housing financed with tax credits, the land may actually be owned by a limited partnership until the tax credits expire, but the CLT normally accepts responsibility for the use of the property beyond the life of the tax credits.)

**Long-term commitments to homeowners.** In the ground leases that CLTs execute with their homeowners, both the CLT and the homeowner commit to a set of restrictions and obligations for a very long time, typically for 99 years. Restrictions are imposed on a CLT homeowner's right to use, occupy, improve, and transfer the home. The CLT is given the right and responsibility to monitor and enforce the homeowner's compliance with these provisions. With this responsibility comes the responsibility to support the homeowner's success during her tenure. Such support often involves providing or arranging for training regarding financial management and home maintenance issues. It can also involve counseling and referrals to help homeowners deal with particular financial, legal or other problems. It sometimes involves providing or helping to arrange loans to the homeowner to bridge specific financial needs. In all cases a CLT's commitment to supporting homeowners (as well as its stewardship of affordable homes) entails protecting against predatory lenders and doing whatever is possible to prevent foreclosure.

A CLT's commitment to support its homeowners is clearly predicated on the assumption that, as ground lessor, it will have the capacity to carry out these functions over the full course of the homeowner's tenure – and will be able to provide the same kind of support for every succeeding homeowner thereafter.

**Long-term preservation of subsidies.** As CLTs have argued for some time, permanent affordability requires subsidies that are locked into the home, rather than structured as a grant or a loan that is either pocketed by the homeowner or recaptured by a funder at resale. In exchange for receiving such permanent subsidies, CLTs must be able to assure local and state governments – and, in some cases, employers and other private sector funders – that CLT homes that are made affordable with their resources will be kept affordable not only for the minimum period of time required by the funder but far into the future so that multiple homeowners will benefit from the subsidy. To provide such assurances, a CLT must have – and should be able to demonstrate that it has – the ability to monitor and effectively manage the resales of subsidized homes over a very long period of time.

**Commitment to the CLT movement.** While there is increasing support for community land trusts across the country – and the number of CLTs continues to grow and the capacity of CLTs continues to build – the fact is that the CLT “movement” is still relatively new and somewhat fragile. The failure of any CLT to survive and keep its promises to its community will undermine the willingness of funders in the region to support other CLTs, and will discourage residents of the region from even trying to start other CLTs. The cumulative effect of a number of CLTs failing across a region or across the country could be devastating to the movement as a whole.

## **Elements of Sustainability**

In this section, we will look at the basic types of capacity, both financial and non-financial, that a CLT must have if its program is to be sustained. Then, in the sections that follow, we will look at the different kinds of financial and non-financial capacity

needed to sustain development efforts and expansion of the CLT's portfolio on the one hand, and those that are required, on the other hand, to carry out stewardship functions even in situations where the portfolio is not expanding.

***Financial Elements of Sustainability.***

Without doubt, organizational sustainability is inextricably tied to money. CLTs require money – available when needed and in sufficient quantities – to meet their responsibilities over time. The key financial elements for long-term organizational sustainability include sufficient revenue, effective cost controls, and sufficient reserves.

**Revenue.** Perhaps the most significant challenge for any organization – new or old, large or small, for-profit or not-for-profit – is to generate sufficient revenue to support everything the organization wants to get done. While it is possible for a financially healthy, credit-worthy organization to bridge *short-term* cash-flow deficits, sufficient revenue over the long term is an absolute necessity. The revenue can come from a variety of sources, but CLTs are primarily concerned with two broad categories: revenue from internal sources (“portfolio revenue”) which is generated by the CLT's real estate holdings and will increase as those holdings increase; and revenue from a variety of external sources, the frequency and amounts of which are less predictable over the long run.

*Portfolio revenue* can include rent that a CLT receives for any conventional rental property that it holds, ground lease fees (or “ground rent”) that it receives from homeowners and others who lease only the land while owning the improvements, and transfer fees (or “lease re-issuance fees”) that can be charged when a ground lessee sells his or her improvements and a new lease is executed with the CLT-approved buyer. (Other types of fees may also be charged to CLT lessees from time to time for specific services.) As will be emphasized below, portfolio revenue is critically important as a source of support for stewardship activities.

*Revenue from external sources* can come from either government sources or private sources. Much of what is received from government sources (and certain private sources) consists of subsidies committed to specific projects. It will be booked by the CLT as revenue and will be spent by the CLT to cover the projects' acquisition and development costs, but it will not be available to cover the CLT's personnel and other operating costs, *except* for that portion of the grant that can be retained by the CLT as what is commonly called a “development fee,” which (in so far as it isn't eaten up by unanticipated project costs) can be used to cover any CLT expense, even if unrelated to the particular project. Government entities can also provide CLTs with direct operating support, like the portion of a local government's allocation of federal Home funds that can be used to support the operation of Community Housing Development Organizations (CHDOs). Though not project-specific, these operating grants are usually awarded to organizations that are actively producing housing, usually not to organizations whose activity is limited to stewardship functions.

Revenue from private sources includes grants from foundations and donations from individuals. Foundation grants can be allocated for general operating support but are more often tied to specific projects or activities. In some cases they are an important source of start-up funding for a new organization, or for the launching of a new program or activity, but they are not a dependable long-term source of support for basic CLT

operations. Donations – large and small – from individuals can be a significant ongoing source of support for organizations willing to work at building a substantial list of potential donors and soliciting them regularly. Donations are likely to be a *more* important source of revenue for CLTs doing affordable housing work in affluent communities or communities where well-to-do people have seasonal homes.

*Endowment.* Some CLTs have sought endowments to reduce dependency on unpredictable grants and contributions and to stabilize their funding streams over time. Building a significant endowment is not easy, and normally takes a long time. For many CLTs, the effort may not be worthwhile. For CLTs working in areas where there are well-to-do property owners, however, soliciting contributions (including bequests) to an endowment may be a viable long-term strategy for supporting organizational sustainability.

**Cost controls.** Cost controls start with a budget, which is simply a financial plan for balancing revenue and expenses. Developing a realistic budget is a crucial first step, but the challenge of controlling costs does not end with this step. Monitoring and controlling organizational costs to keep them from exceeding the budget is necessary. Too often, nonprofit organizations “leave their budgets behind” as they throw themselves into day-to-day work and allow the day-to-day demands of the work to overwhelm budgetary controls. There may be times when the demands of certain work should dictate amendments to a budget, but these demands should not cause the organization to push ahead without considering how the previously unbudgeted costs are to be paid for.

For the long term, effective budgeting and cost management requires careful cost-benefit analysis. The ideal system for this purpose will track both the costs of each program or major activity and the results of the activity (or the indicators of results) and will compare the two, so that the organization can evaluate whether the results justify the costs. Such an analysis will help an organization to determine not only how to control costs but also how to increase its effectiveness.

**Reserves.** Even if an organization generates sufficient revenue to meet its budgeted costs and controls those costs effectively, it will still be financially vulnerable if it is never able to create reserves by generating revenue *in excess of* its expense during at least some periods of operation. CLTs should in fact budget for a certain amount of net income to be generated each year. The net may be budgeted as (and then formally committed to) an “operating reserve,” to be maintained as a separate account on the organization’s books, or it may simply be allowed to accumulate from year to year as an annual increase in the *liquid* portion of the organization’s overall fund balance. (Depending on how the value of its land holdings and related liabilities are booked, a CLT can easily have a large, positive fund balance while being “land poor” – with no ability to liquidate any of its land holdings.)

Whether treated as a dedicated reserve or as a liquid fund balance, the accumulated cash will be important in two ways: it will relieve the need to seek loans or draw on a line of credit (or defer payment of bills) when expected revenue is delayed (e.g. when governments are slow in disbursing grants); it will also allow the organization to survive a bad year when expenses in fact exceed revenue, again without relying on credit or deferring payments. In either case the organization will benefit both by avoiding

potentially substantial interest expense and by avoiding the appearance of vulnerability that might scare off potential future sources of revenue.

Another type of reserve fund, a reserve used to fund the cost of major replacements or repairs in the homes of CLT homeowners, is discussed below in connection with the sustainability of a CLT's efforts to preserve the quality of the homes on its land.

### ***Non-Financial Elements of Sustainability***

These non-financial elements are of course related to financial sustainability. Overall organizational capacity is not free, but it does entail elements that money alone will not provide. Organizational sustainability is supported by clear goals and strategic planning, an effective governing board, a competent staff, strong executive leadership, an engaged membership and constituency, government support, broad-based community support, and, where possible, strong partnerships with other organizations working in the community .

**Clear goals and strategic planning.** Every CLT must clearly define its mission and the specific goals that its mission entails from year to year. It must also establish realistic strategies that will enable the organization to achieve the identified goals over time. Each CLT must commit itself to review its goals and strategies regularly, and to modify them as needed, in order to remain true to its mission and relevant to the community (or communities) in which it operates. Most importantly, every CLT strategic plan must include a plan for sustaining the necessary stewardship activities in periods of time when other more “grantable” activities are not being carried out.

**Board Leadership.** A committed and effective board of directors guides the organization in carrying out its long-term mission, aids the organization in strategically planning for its future and assures the sound management and operation of the organization. With their commitment to engaging and empowering diverse community interests on their governing boards, CLTs face a significant challenge: they must find the right individuals to serve as directors and must involve them in the workings of the organization. To assure the long-term continuity of their organizations, it is particularly crucial for CLTs to recruit and nurture effective, committed boards of directors. And in order to build continuity and permanence, every CLT, from year to year, must orient and educate new board members regarding the mission, goals and strategies of the organization.

In addition to maintaining *active* boards of directors, it is important for CLTs to maintain boards of directors with a *balance* of interests, as contemplated by the three-part board of the “classic” CLT model. The CLT's tripartite board structure not only provides a reasonable model for effective governance but also helps to sustain the organization, as each interest group makes its own contribution to organizational stability, accountability, and health.

**Staff and executive leadership.** Even relatively small CLTs must employ staff – with sufficient skills, knowledge, and commitment to carry out the program defined by the board of directors. To function effectively, all staff must have clear job descriptions and experienced supervision, consistent support, and the resources needed to do their jobs. These conditions, in turn, depend on the organization having an effective executive director.

Many CLTs – especially those with strong executive directors – give too little attention to what might happen if this individual were to move on. Without a carefully thought out executive transition plan in place, any change in leadership could result in an otherwise successful organization finding itself destabilized. And planning for a successful future simply cannot be done effectively in the midst of a crisis, especially during a crisis of leadership. For this reason, every CLT should not only develop an emergency executive transition plan – prescribing the process to deal with an unplanned absence of its executive director – but should also design and implement a strategic leadership development plan focused on expanding the organization’s pool of capable leadership. (There is a great deal of good information available regarding leadership transitions. An excellent example is *Building Leaderful Organizations – Succession Planning for Nonprofits*, written by Tim Wolfred and published by the Annie E. Casey Foundation.)

**Engaged membership and constituency.** As membership organizations, CLTs draw members from the neighborhoods they serve, from the people they house, and from the broader communities that support their work. For most CLTs, recruiting, mobilizing and retaining an active membership is a critical step toward building a sustainable organization. And even for CLTs that are not established as membership organizations, it is important to involve the CLT’s primary constituency, its homeowners and tenants, if the organization is to have the kind of energy and commitment needed to survive when times are hard. The more people who believe they have a stake in the CLT’s survival, the more likely it is to survive.

**Government support.** It is critically important for CLTs to have the support of local government, and in particular the support of those government agencies that regulate and fund affordable housing efforts. As is emphasized in Chapter 2, “Initial Choices,” developing positive relationships with these agencies should be one of the first concerns of new CLTs. And maintaining such relationships should continue to be an active concern, year in and year out. A CLT cannot afford to neglect these relationships, whether it has specific funding requests pending at the time or not.

**Broad-based community support.** To be successful over time, CLTs must build support for their goals and strategies within the communities in which they operate. CLTs are place-based organizations, providing critically needed resources for a not-always-popular constituency with a relatively unfamiliar methodology. It is therefore important for every CLT to build the strongest possible base of awareness and support for its mission and activities in the community in which it operates. This support should include both *institutional support*, coming from faith-based institutions, employers, civic organizations, nonprofit agencies, and the like, and *popular support*, coming from the broadest possible mix of people living in the communities served by the CLT.

**Strategic partnerships.** Flying solo has its costs. Collaborative partnerships provide an opportunity for community land trusts to increase their impact while sharing – and thereby reducing – operating costs. Many CLTs have formed effective partnerships with organizations operating complimentary programs. Examples of such programs are those involving homebuyer education, housing development, property management, services for low-income homeowners, legislative advocacy, and a number of other tasks that are necessary to the success of a CLT’s efforts but that do not necessarily need to be

performed by the CLT itself. With any such partnership it is of course important that there be a clear understanding between the partners regarding the specific roles and responsibilities of each and the processes by which they will coordinate their respective tasks.

### **Planning for Growth**

Although our primary focus in this chapter is on the CLT's long-term capacity to steward whatever holdings it does eventually have, the *expansion* of holdings remains a significant concern for CLTs, both as an essential activity in its own right and because it is the factor that will determine what must eventually be stewarded.

The expansion of a CLT's holdings happens through either of two processes: either through the CLT's own development efforts or through arrangements whereby it acquires land on which others have developed or will develop housing (or which will be improved for non-residential purposes). Of the two processes, development typically calls for substantially more capacity, but both call for elements of capacity that are not needed by CLTs at a time when they are *only* carrying out their stewardship functions.

**Development capacity.** Housing development entails completion and coordination of a great many tasks – from the initial identification of possible sites for projects, to the development of initial plans and preliminary budgets to determine the feasibility of proposed projects, to the necessary work with architects and engineers, to the process of gaining the necessary permits and completing the necessary reviews of environmental impacts and other factors, to the process of refining financial pro formas and securing the necessary grants and loans, to the process of contracting with builders and overseeing construction – all the way to the point where a certificate of occupancy can finally be issued. Although some small CLTs have waded into these tasks with very little previous experience and have managed, on a limited scale, to “learn by doing,” any CLT that wants to build real development capacity must have within its staff a substantial body of knowledge and experience, and must be able to commit enough staff time for each project to see that it is completed cost-effectively and on time.

If building the capacity to complete a given development project is challenging, *sustaining* this kind of capacity for the long term is even more challenging. Unlike many other aspects of a typical CLT program, housing development work *can* pay for itself through development fees or “profit” taken when a home is sold to an owner-occupant. However, development happens project by project. The projects typically stretch out over an extended period of time, during which the developer must not only pay project-specific costs (pre-development costs, acquisition costs, construction costs and other development costs) but must cover payroll expense for the necessary development staff. But the “profit” from the project usually will not be received until development is completed and the homes are sold. Managing such projects means that a CLT must not only have substantial financial capacity coming into a project – so the project won't be stalled half-way through by a lack of cash – but must also have substantial expertise in planning and managing a reasonably steady *flow* of projects so that there will be enough staff capacity (and cash) at every point in each project while avoiding lulls between projects when there is not enough work to make cost-effective use of staff that must still be paid.

Given the challenges entailed in creating and sustaining development capacity, all CLTs must think carefully about the extent to which it makes sense for them to try to build such capacity. Probably the most important reason for a CLT to want the capacity to do its own development is that it will then have real control over the location, type, quality, quantity and timing of what will be produced. A number of CLTs have begun with the idea that they did not need to do their own development and did not want to compete with existing housing development organizations but have then found that it was difficult or impossible to align their own housing goals with the development agendas – and schedules – of these other organizations. In order to take control of their own agendas most CLTs have in fact found they needed to have at least some degree of internal development capacity. The other major reason that CLTs have tended to want their own development capacity is, again, that development is an activity that can actually pay for itself and may even – possibly – generate enough revenue to help pay for other activities as well. Many CLTs have therefore believed that it was financially advantageous to do their own development.

Notwithstanding these reasons for a CLT to act as its own developer, there are also significant reasons for it *not* to do so – or at least for it to limit the kinds of situations in which it will do so. As suggested above, housing development programs, and especially larger development projects, require the ability to manage complicated financial scenarios of a sort that would otherwise be unnecessary. Furthermore, development entails serious financial risks. Cost overruns are common. All sorts of unanticipated circumstances can increase the cost of labor and materials, and all sorts of delays in the completion of development or in the sale of the developed housing can increase the “soft costs” of development such as insurance and interest expense. Most of these cost overruns will mean a reduction in the development fee or profit that the developer can take from the project, and, in the worst case, such problems may not only wipe out the project’s financial benefits for the CLT but result in a serious financial crisis for the organization.

**Other aspects of growth capacity.** Regardless of whether CLTs do their own development, there are other tasks that must be planned, staffed and paid for in order to expand the organization’s holdings. The more homes a CLT produces or acquires, the more homes it must be prepared to market and the more qualified homebuyers it must identify, orient, educate, counsel, and assist in obtaining appropriate financing. Even a CLT that is *not* doing its own development is still likely to need the capacity to handle at least some of these tasks, depending on how responsibilities are allocated between the entity that *is* doing the development and the CLT itself. It is important to note that, in negotiating the allocation of responsibilities in such situations, CLTs should also negotiate the allocation of *funds* to support the responsibilities. In particular, CLTs should avoid arrangements with developer-partners that will bring them *unfunded* responsibilities for essential marketing and homebuyer assistance tasks. A developer that is profiting from the production of homes while relying on a CLT to deal with these tasks should be prepared to pay for the services (or the subsidy source should be prepared to pay).

**The effects of growth planning on long-term stewardship capacity.** A CLT cannot expect that growth will be steady over the long term. There may be times when a CLT will have reasons to increase its growth capacity to meet increased demand for affordable

homes and to take advantage of available project opportunities. But there will be other times when demand and opportunities are diminished and a CLT must slow or even halt its efforts to expand its holdings, at least temporarily. It may be reasonable for development capacity to be reduced in such circumstances, but the stewardship responsibilities that the CLT has accumulated will *not* be reduced. It should go without saying that, in planning for the expansion of holdings, CLTs must also plan for an expansion of stewardship capacity proportionate to the *cumulative* increases in the number of homes for which the CLT takes on long-term responsibilities.

In planning for growth CLTs should also recognize the effects that different *kinds* of growth will have on stewardship responsibilities. When a CLT undertakes a project that involves an ownership model it has not dealt with before – whether a condominium project, a limited equity-coop project, a rental or lease-purchase project, or perhaps a nonresidential project – the CLT will not simply be adding more of the kinds of responsibilities that it already has; it will be adding new *types* of responsibilities, which are likely to call for knowledge or skills different from those already present in the organization. Similarly, the nature of a CLT’s long-term responsibilities can be affected by growth that involves a clientele or neighborhood circumstances different from those it has dealt with in the past.

Though the various effects of growth on stewardship responsibilities are obvious enough, the awareness of this fact is often pushed into the background when a CLT is caught up in the excitement (or anxiety) of rapid growth and/or the planning of a new development project. At such times it is tempting for the organization to think that planning for stewardship can wait until later, when “things have cooled down.” The problem, as will be emphasized in the next section, is that some of the resources that will be needed to carry out stewardship responsibilities can be more readily accessed and committed to this long-term purpose during periods of growth than during periods when stewardship activities are the organization’s *only* activities. Therefore, planning for stewardship should be treated as an integral part of – and should never be subordinated to – planning for growth.

### **Planning for Sustainable Stewardship**

The activities required to carry out a CLT’s stewardship responsibilities with owner-occupied homes are discussed in some detail in Chapter 23, “Post-Purchase Stewardship Tasks.” (Special stewardship responsibilities related to condominiums and limited equity coops are discussed in Chapters 14 and 15.) These activities add up to a substantial body of work that must be done year in and year out – even if all of the CLT’s growth-related activities have ceased. In fact the financial challenge of sustaining the CLT’s stewardship capacity is likely to be greatest during those times when stewardship activities have become the only activities and when more readily “grantable” growth-related activities are discontinued. We therefore recommend that all CLTs assume that they may at some point have to carry on their stewardship work in such a situation and that they address, sooner rather than later, the truly challenging question of how they will support that work.

**Variables affecting stewardship plans.** The exact nature of the stewardship responsibilities for which a CLT must plan will depend on the *eventual* nature and

quantity of its holdings. The plan must also take into account the size of the geographical area in which the holdings are located and the anticipated scale and pace of growth.

*Types of housing.* Our primary emphasis in this chapter is the set of stewardship responsibilities related to resident-owned single-family homes – because these are the responsibilities most often neglected in a CLT’s long-term planning – but many CLTs do own rental housing, which involves a significantly different set of management responsibilities. In addition, a growing number of CLT portfolios also include condominium units, and some lease land to, and/or provide services to, limited equity housing coops, or to manufactured housing park coops or resident associations. And some have developed single-family subdivisions involving homeowner associations. Each of these “common interest” ownership models entails distinctive stewardship responsibilities for CLTs.

*Number of housing units.* Obviously the number of units will have a major effect on the stewardship capacity required. A CLT with a few units may be able to handle its stewardship responsibilities with volunteers, whereas a CLT with a hundred units may need a full-time staff person, and a CLT with a thousand units will need multiple staff people (to oversee, among other things, what is likely to be more than a hundred resales per year).

*Nonresidential properties.* Is the CLT also responsible for managing and preserving properties that are at least in part non-residential, such as commercial facilities, “live-work” facilities, or facilities for other nonprofit programs? Does the CLT also own community gardens, parks, or recreational facilities? Does it hold easements on wild or agricultural land? Each of these different types of holding entails different responsibilities.

*Size of geographic service area.* Is the CLT serving a single neighborhood, or a citywide (or larger) area? A staff of a given size that is adequate for a given number of homes concentrated in a small area may be inadequate for the same number of homes if they are scattered through a wide area.

*Anticipated pace and scale of growth.* Stewardship capacity must expand as holdings expand, but neither type of capacity can be expanded as smoothly as one might wish. A CLT that is developing a large project may, at some point, increase its staffing to deal with the increased stewardship responsibilities, but it may not be easy to predict exactly when that point will come – that is, exactly when those new homes will be sold and occupied. And even if holdings increase relatively smoothly through a series of smaller projects, it will not necessarily be easy to increase stewardship capacity smoothly. There will be times when more staff will need to be hired and/or responsibilities of existing staff will need to be shifted to cover expanded stewardship responsibilities.

### ***Financial Elements of Sustainable Stewardship***

If essential stewardship responsibilities are to be fulfilled even in the absence of other program activity, how is the work to be paid for? As we have suggested above, a CLT’s “*portfolio revenue*” – consisting of the lease fees (and any conventional rental income) collected each month and the transaction fees collected when homes are resold – must be seen as essential to the answer. In fact, when a CLT is no longer growing and is not actively planning to grow in the immediate future, its predictable revenue may be more or less *limited to* its portfolio revenue. (We will note some other possible sources of

revenue below, but we do not encourage CLTs to rely on them as primary sources of long-term stewardship support.) For CLTs that are not growing, there will not be any project funding, from either public or private sources, so there will be no development fees to help cover payroll and other operating expenses. Nor are there likely to be operating grants from public or private sources that see their mission in terms of supporting the *production* of affordable housing.

**Rental income.** For CLTs that own and operate rental housing, rental income will be significant, but we will not deal here in any detail with financial management of rental programs, which is a subject, not unique to CLTs, for which detailed guidance is available elsewhere. For our present purposes, suffice it to say: (1) that rental housing calls for a distinct kind of stewardship capacity that must be sustained for the long term, (2) that a CLT with rental housing should assume that this part of its housing program should pay for itself, but (3) that the CLT should also assume that the rental program, though it will expand the organization's cash flow, will *not* generate excess revenue that can be used to support other stewardship tasks.

**Ground Lease Fees.** The subject of ground lease fees is addressed in some detail in Chapter 13, "Establishing and Collecting Lease Fees." The ability to collect these monthly fees has two important benefits. The first is the ongoing "checking-in" relationship that these fees establish between CLTs and their homeowners. The second is the steady stream of revenue the fees provide to cover some of the CLT's costs of managing its portfolio of resale-restricted, owner-occupied housing.

In the past, most CLT leases treated the lease fee as an undivided dollar amount that could be put to use in any way the CLT saw fit. Today, however, a growing number of CLT leases define the lease fee as including both a "land use fee" and a separate amount that is committed to a "repair reserve," the use of which is restricted to funding necessary repairs and replacements in owner-occupied CLT homes. Creation of a repair reserve is now highly recommended. (See the commentary on Section 7.6 of the 2011 Model Lease in Chapter 11-B.)

Because the *amount* of the lease fee is established in the CLT lease and can be increased only within limits that are also stated in the lease, it is extremely important for CLTs to think carefully about the long-term importance of the fee when initially deciding on the amount of the fee. The tendency of many CLTs – a tendency frequently reinforced, if not required, by subsidy providers – is to minimize the amount of these fees in order to reduce the homeowner's total monthly housing costs (which means that less subsidy is required to make those costs affordable, which in turn allows more homes to be subsidized.) Particularly when CLTs are starting up – and adopting the ground lease that they expect to use for years to come – they are focused on *growth* and give too little thought to how they will support the long-term stewardship responsibilities that growth will entail. As a result, the overwhelming majority of CLTs in the U.S., assess monthly lease fees in the range of \$15-\$30 per month, with a few venturing as high as \$50 or more. The unintended consequence of this well-intentioned practice, however, is that a form of revenue that is actually intended to support ongoing CLT stewardship work will be inadequate for that purpose.

An increase in the lease fee of just \$25 per month may seem inconsequential when a CLT is focused on its first few units, but, at the point when it has accumulated a portfolio of 100 homes, that extra \$25 per month will generate an extra \$30,000 per year (resulting

in a total of \$60,000 if the total fee is \$50/month). At a time when a growing number of affordable housing funders are concerned with preserving affordability for the long term and are therefore taking an interest in the CLT model, it behooves all CLTs to make the case that the CLT's long-term role entails significant costs and that it is entirely appropriate for the funders of long-term affordability to do more to help cover these costs. (In fact, one state housing finance agency has gone so far as to *require* CLTs receiving their subsidy funds to charge at least \$50/month lease fees of their homeowners. Of this amount, \$25 is to be set aside for necessary stewardship work in the future. In turn, the agency provided sufficient additional subsidy to offset the loss of affordability to the CLT homeowner otherwise resulting from the increased monthly lease fee cost.)

**Transfer fees.** These fees (sometimes known by other names) may take several different forms. Under the terms of leases based on older versions of the Model Lease, it was possible for a CLT to purchase a home when the owner wanted to sell, then resell the home to an income-qualified purchaser for a somewhat higher but still affordable price; or it was possible for the CLT to exercise its purchase option, then assign the option to another purchaser and charge that purchaser a fee for the assignment of the option. Until recently, however, very few CLT leases allowed the CLT to capture revenue from the transfer of a home *unless* the CLT did first exercise its option to purchase. But the 2011 Model Lease does specifically provide for a transfer fee that can be charged to the buyer even if the purchase option has not been exercised (the fee is added to the price that the seller is permitted to receive). The amount of the fee is usually limited to a specified percentage of the price received by the seller (usually something less than – and definitely not exceeding – the percentage that a realtor would receive for selling the home in a conventional market situation). The CLT can of course reduce or waive this fee when necessary to preserve affordability, but it is now strongly recommended that all CLT leases be written so as to allow a transfer fee to be charged when it is affordable.

It is also possible for a CLT to charge a marketing fee to the *seller* of the home – either as a licensed listing agent (if the CLT is in fact a licensed broker) or by helping to find a buyer by less formal means. However, it is possible to charge the seller *only* if the ground lease specifically permits it or if the seller enters into a formal contract with the CLT for such services. In general, it is preferable to treat the purchase option price as an amount that the seller has a right to receive in full, and to cover the CLT's costs in overseeing the transfer through a fee that is *added to*, rather than subtracted from, the purchase option price.

The amount of work entailed for CLTs by transfers of ownership will vary, depending on market and other conditions, but it will be significant in any case. It will normally include making sure that homes are in satisfactory condition when transfers take place, that the purchasers are income-qualified, that resale prices do not exceed the purchase option price, that purchasers understand the nature of CLT homeownership and the restrictions and requirements imposed by the CLT lease, that appropriate letters of agreement and attorneys' acknowledgement are presented, that purchasers have leasehold mortgage financing on permissible terms, that all aspects of the "CLT deal" are satisfactorily executed and recorded, and that all necessary documents are received by the CLT and properly filed when the transaction is closed. Transfers also entail a greater or lesser amount of work by the CLT in identifying potential buyers and helping them

prepare for purchase. (For more on the extensive CLT responsibilities related to resales, see Chapter 22, “CLT Real Estate Transactions,” and Chapter 23, “Post-Purchase Stewardship Tasks.”)

The necessary body of work will normally require a significant amount of staff time, and therefore significant cost for the CLT. It is entirely reasonable for CLTs to seek to cover the cost of this work through a fee that will be triggered when the occasion for the work in fact arises. In the short term, the frequency of such occasions is hard to predict – a homeowner may sell after as little as one year of ownership or after decades of ownership. But the average tenure for CLT homeowners is probably something like seven years. A typical situation for an older CLT might be one in which the CLT owns the land beneath 100 homes and anticipates an average of a little over 14 resale transactions a year. If these resales can generate an average of \$3500 per transaction in transfer fees, it will mean average annual transfer fee revenue of about \$50,000 for the organization.

It must be acknowledged that there may be periods of time when transfer fees in the \$3500 range would increase the final resale price to a level where it would be difficult for the CLT to find income-qualified households for whom the price is affordable, or difficult to find households who would be willing to pay the price (and able to finance the price) even if it is technically affordable. The likelihood that future transfer fee revenue will be limited by such circumstances will depend in part on the original base price set by the CLT (see Chapter 18, “Project Planning and Pricing”), and in part by the particular resale formula the CLT has adopted – and on whether long-term market conditions have resulted in prices generated by that formula that are increasingly affordable (i.e. affordable to households at lower and lower percentages of AMI). The affect of resale formulas on a CLT’s future ability to charge a significant transfer fee is *one* reason for CLTs to lean toward adopting formulas that are more likely to increase affordability over time than to decrease it. Thus, like the CLT’s initial decision regarding the amount of its lease fee, the initial choice of a resale formula will have much to do with the long-term sustainability of the organization’s stewardship capacity.

**Revenue from external sources that may help support stewardship.** Although government agencies and larger foundations are not likely sources of support for CLTs focused only on stewardship activities, there are other possible sources of external support that may well be significant in this situation – especially for CLTs that have been successful in building community recognition and support of their stewardship work as well as their housing production work. CLTs that are focused on stewardship work can and should keep their communities informed about the nature and importance of this work. After all, the stories that can be told about the resale of homes may be even more affecting for members of the public than the stories of initial home sales. At the time of resale the story involves not one but two households – one that has already benefitted from CLT homeownership and perhaps taken a step up economically, and another one that will now have the opportunity to take that step. It is, in fact, a time when the distinctive virtue of CLT stewardship is most visible. It is therefore a good time to ask CLT members and other individuals in the community to make donations to help support the ongoing work. It is also a good time to ask local corporations for grants or donations – perhaps most notably banks that have a financial interest in the CLT’s stewardship

work and are continuing to lend to CLT homebuyers – and are therefore aware that the CLT is still active even though it is not currently increasing its holdings.

**Financial strategies that may or may not be cost-effective.** Organizations facing diminished external revenue sometimes consider launching new programs or activities in the hope that they will generate revenue that will help support essential existing activities. Too often, however, these organizations do not take into consideration the full cost of such efforts. The challenge facing CLTs looking to diversify their activities as a means to increase program revenue is to make sure that the organizational “give” is not greater than the organizational “get” – i.e., that the time, attention, staffing resources and funding required to gear up for and sustain this new activity is worth the revenue that is *actually* to be earned as a result of this activity. For example, at least one established CLT, after implementing a pilot fee-for-service technical assistance program, decided to discontinue the program when it became apparent that the cost to the organization was more than the program was earning for the organization. In general it would be wise for CLTs to consider such a program only if they have highly qualified staff whom they want to retain but whose time is not currently fully utilized by essential duties.

While *new* fee-for-service activities are rarely an effective way of increasing net revenue, we should emphasize that the CLT may already be delivering some specific stewardship services that do generate fees and/or are funded by external sources. For example, some operate “Homeownership Centers,” or other homebuyer training and counseling programs, that may pay for themselves while covering an essential piece of the CLT’s stewardship responsibilities. Some also operate loan funds that provide loans to the CLT’s homeowners for purposes such as home repairs – a significant stewardship service that can generate some interest and fee revenue. Others may be engaged in managing rental property, and may therefore have maintenance staff who can provide certain home repair services to CLT homeowners and generate some fee-for-service income in the process.

### ***Non-Financial Elements of Sustainable Stewardship***

As emphasized earlier in this chapter, sustainability involves more than revenue considerations. For CLTs that are not expanding their holdings, the fundamental question is: how can we make efficient use of the limited revenue that we have in order to see that we fulfill our responsibilities regarding our holdings? An important part of the answer, as noted earlier, is cost-control, which entails careful budgeting and diligent financial oversight, but which also entails finding the most efficient, inexpensive ways of doing what needs to be done. In this regard we will look at the particular importance, in times of non-growth, of active board leadership, of resident engagement, of utilization of part-time and shared staff and volunteers and partnerships with other entities, and of efficiencies of scale.

**Board leadership.** Boards of directors tend to be energized by situations where they can participate in planning for growth and can help launch new projects. Typical boards tend to be less energized by the ongoing day-to-day work entailed by a CLT’s stewardship responsibilities. These reactions are understandable; nonetheless, energetic board leadership may be *most* important in these situations where the question facing the organization is not “how can we grow?” but “how can we sustain the work we have already said we will do?” If the board loses interest in such situations, if its members are

less passionate about the future of the organization, if it becomes increasingly difficult to recruit energetic new members, then the commitment, energy, and efficiency of the whole organization is likely to suffer. The process can easily become self-perpetuating and can possibly pull the organization into a downward spiral from which escape will be difficult. Clearly, then, it is important for those who care about the future of the organization to anticipate the possibility of – and take steps to prevent – any such loss of momentum at the board level.

One way to prevent the loss of board energy when the excitement of growth is no longer present is to be sure from the start that a significant part of the board is at least as interested in the CLT's stewardship functions as in its growth potential. One of the sometimes neglected virtues of the classic CLT board structure is that it does ensure that one-third of the board (the resident member representatives) will have a compelling reason to be interested in the stewardship function, and that another one-third (the non-resident member representatives) will be likely to include residents of neighborhoods where the CLT already holds property, who have reason to be more interested in the CLT's stewardship efforts in those neighborhoods than in potential new projects in other areas. In fact, one can point to a number of older classic CLTs that are no longer growing but that manage their holdings with some (variable) degree of success. One can also point to a few failed CLTs whose boards and/or executive leadership were oriented toward aggressive development but had only very limited interest in – or commitment to – post-development stewardship. Once again, it is important to maintain a balanced board from the start.

**Resident engagement.** Community land trusts can strengthen the sustainability of their organizations by capitalizing on the long-term relationships they have with their homeowners. By engaging meaningfully with its homeowners – by treating them less as *beneficiaries* and more as responsible stakeholders and partners – a CLT can enhance the prospects for sustainability in several ways.

*Strengthening the board of directors.* Engaged homeowners who are elected to the board as homeowner (lessee) representatives will help energize the whole board and will provide important first-hand information about the state of the CLT at the grassroots level and the state of the neighborhood(s) in which the CLT is working. (Homeowner representatives who are passive and disengaged in their relationship with the CLT are likely to be passive in their relationship with the board.)

*Increasing cost-effectiveness of staff work.* As emphasized in Chapter 23, “Post-Purchase Stewardship Tasks,” the tasks performed by CLT staff are likely to be more cost-effective when homeowners are engaged and ready to cooperate with and assist those efforts. Such homeowners are more likely to pay their lease fees and comply with other ground lease requirements in a timely way. They are more likely to inform staff regarding potential problems before the problems have snowballed into hard-to-resolve situations. They may also provide direct help in carrying out some necessary tasks, such as training functions and assistance to other homeowners, that would otherwise need to be carried out by staff.

*Helping with fundraising.* Involving CLT homeowners in funder site visits, or in outreach to businesses where they work or religious institutions where they worship, or in making presentations to other potential donors, can significantly strengthen the CLT's

ability to raise money from local sources. The simple fact of their involvement on behalf of the organization is likely to impress potential donors.

**Part-time, free, and shared labor.** For smaller CLTs that cannot afford full-time staff – as is the case with many small nonprofits – the difference between sustainability and failure is likely to be a matter of assembling an effective combination of part-time and volunteer workers and/or a matter of working out partnerships or staff-sharing arrangements with other organizations. And even for CLTs that do employ full-time staff, utilization of these alternative staffing arrangements may play a crucial role in shaping a cost-effective program that will be able to handle a workload that would be too much for the organization’s full-time staff alone.

*Part-time staff.* People who work part-time are not necessarily just “partly qualified.” There are highly qualified people who, for one reason or another – perhaps because they have young school-age children – are actively seeking part-time work. Nonprofits that are flexible in their approach to staffing can make very good use of such people.

*Volunteers.* It is often possible to find volunteers who will be happy to help from time to time with simple but time-consuming tasks such as stuffing envelopes. It may also be possible to find people – perhaps retirees – who have useful knowledge and skills and are willing to take on certain ongoing responsibilities such as bookkeeping or grant-writing or property inspections, among other possibilities. In addition, professional firms often provide pro bono services to 501(c)(3) organizations, and for-profit businesses may donate valuable services as well as products.

*Shared labor and partnerships.* Several kinds of staff-sharing arrangements are possible. It may simply be a matter of two organizations agreeing that each will employ a given person on a half-time basis. Or it may be a more flexible arrangement, where another organization agrees to contribute certain staff services to the CLT – either in return for other services provided by CLT staff or simply because it views the CLT’s work as complementary to its own. In one case a CLT received homebuyer-training, marketing and administrative assistance from another housing organization in return for the services of a CLT staff person with expertise in capital needs assessment. Several CLTs that were doing little or no development of their own have shared an executive director with a complimentary housing development organization.

**Economies of scale.** For rental housing programs the conventional wisdom is that a certain (variously specified) minimum number of rental units will be necessary in order to reduce the cost of management to an affordable per-unit amount. Some of the same economy of scale is likely to apply to the stewardship of CLT homeownership programs. A CLT program does involve some fixed costs, which will have a greater effect on the per-unit cost of small holdings than on the per-unit cost of large holdings. Nonetheless, the situation for a CLT is more variable than is the case with rental management. The cost-effectiveness considerations discussed above can all affect the number of units that will yield the greatest efficiency for CLT stewardship programs. A small CLT with a dynamic board of directors, engaged homeowners, willing volunteers, and cooperative relationships with one or more other agencies serving the same area may well cover its stewardship responsibilities at less cost per unit than a larger CLT with many more units and a more conventionally staffed operation.

The extent to which a CLT's units are geographically concentrated is also a factor. A CLT with a hundred units in a single neighborhood is very likely to have lower per-unit costs than a CLT with a hundred units scattered throughout a metropolitan area – both because the amount of time and money required for staff travel will be less and because the CLT with the neighborhood-based program will probably find it easier to mobilize assistance from the CLT homeowners themselves and from other local volunteers.

## Summary

Because of the strategy it uses and the terms of the ground leases it signs, every CLT has a mission-driven responsibility – and, to a degree when receiving public funds, a legal obligation – to preserve the affordability, promote the upkeep, and prevent foreclosures among the homes in its portfolio. These stewardship responsibilities and obligations must be carried out for the term of each CLT ground lease – and will be renewed whenever homes are sold and new leases are executed. Every CLT that chooses to enter into long-term, inheritable, renewable ground lease agreements with its homeowners must have a plan in place, therefore, to create and perpetually maintain the organization's stewardship capacity.

Clearly there is no single detailed “sustainability plan” that can serve as an appropriate model for all CLTs. Each CLT must assess its own situation and make realistic plans for its own future. In developing such plans, however, there are some basic principles that all CLTs should keep in mind.

- It is important, from the start, to plan for sustainable stewardship capacity, not just growth capacity. For this reason a CLT's board of directors should include people with a particular interest in the stewardship role, not just people with a particular interest in housing production.
- In planning for sustainable stewardship, it is important to assume that there will be times when stewardship activities will be the organization's only activities, even if such times are many years away.
- It is important to recognize that, when a CLT is not actively expanding its holdings, the types of revenue available to it will be limited, and will consist primarily of “portfolio revenue” – lease fees and transfer fees.
- In determining the amount of the lease fee that will be written into the CLT's ground lease, it is important to think carefully about the significant effect the fee will have on the organization's ability to support future stewardship activities.
- It is important for a CLT's ground lease to permit the CLT to collect a transfer fee without necessarily exercising its purchase option, and it is important for the CLT's initial pricing and resale formula to preserve a wide enough margin of affordability and marketability to allow a significant transfer fee actually to be collected.
- Sustainability requires a kind of organizational vigor that involves more than financial capacity. It is important to build and preserve not only a competent staff but an energetic board of directors, an active membership and engaged homeowners.

## Chapter 25

# Dealing with Worst Cases

The previous chapters of this manual have dealt primarily with the subject of how to avoid problems in specified areas, or how to prevent problems in these areas from reaching the stage where they can be addressed only through some form of legal action. In this chapter we will review basic factors that a CLT must consider if it does face certain of these “worst case” situations. Specifically, we will discuss issues involved in dealing with homeowner mortgage default and foreclosure, non-permitted mortgages, monetary lease defaults, and nonmonetary lease defaults. And finally we will look at some legal options available to CLTs that are unable to sustain their stewardship functions and must therefore seek help from other entities, or transfer property to other entities.

### Dealing with Mortgage Default and Foreclosure

Chapter 23, “CLT Post-Purchase Stewardship,” describes the important monitoring and support activities by which a CLT can help homeowners avoid mortgage default, or, if they do default, help them avoid foreclosure. Chapter 20, “Financing CLT Homes,” describes the CLT’s basic concerns regarding mortgage default and foreclosure and the provisions of the Model Lease that give the CLT certain rights in dealing with these concerns. These rights include (1) the right to cure a default on behalf of the homeowner, (2) the right to purchase a defaulted mortgage from the mortgagee, and (3) a right to buy back a foreclosed home from a mortgagee that has taken title to it.

In this chapter we will focus on worst-cases where the homeowner’s default cannot be cured and where it is not possible to arrange resale of the home before foreclosure ensues, so that the CLT must deal with the foreclosure process if it is to regain control of the home and its affordability. For those who do have to deal with the foreclosure of a CLT home it will be important to work with an attorney who is familiar with the details of the foreclosure process as defined by the laws of the state in question. It is also important for CLT personnel themselves to have a clear basic understanding of how that process will work.

**Foreclosure issues in “lien theory” and “title theory” states.** State foreclosure laws can differ with regard to a number of details, but in general these laws take one or the other of two distinct approaches. One is the approach taken in “lien theory” states, where the homeowner/mortgagor retains title to her property, with the mortgagee holding a lien on the title for the life of the mortgage. In the event of an uncured default, the mortgagee can bring suit against the homeowner, initiating a judicial process whereby the lien can be foreclosed and title to the property awarded to the mortgagee. The other approach is that taken in “title theory” states, where the “mortgage” (to use the more general, less precise term) takes the specific form of a “deed of trust” or “trust deed” or “mortgage deed,” whereby title to the mortgaged property is not actually held by the homeowner/mortgagor but is held by a trustee (usually a title company), for the mortgagee until the loan is repaid. In the event of an uncured default, the mortgagee can, without the action of a court of law, ask the trustee to sell the property at auction and use the proceeds to repay the loan.

Deeds of trust are the most common or only mechanism for financing real estate purchases in the 30 “title theory” states: Alaska, Arizona, Arkansas, California, Colorado, the District of Columbia, Georgia, Hawaii, Idaho, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Hampshire, North Carolina, Oklahoma, Oregon, South Dakota, Tennessee, Texas, Utah, Virginia, Washington, West Virginia, and Wyoming. However, most of them (all except the District of Columbia, Michigan, New Hampshire, Tennessee, and West Virginia, where the deed of trust is the only financing mechanism) also allow judicial foreclosure. Trustee sale and judicial foreclosure are equally used in Arkansas and Hawaii. Judicial foreclosure is more common in Oklahoma and South Dakota. The 21 other states generally use mortgages (in the strict sense of the term) though trustee sale is allowed in Iowa and Rhode Island with trustee sale more common than judicial foreclosure in Rhode Island.

With either approach, the mortgage or deed of trust normally gives the mortgagee the right to “accelerate” the loan in the event of an uncured default. When the loan is accelerated, the entire unpaid balance of the loan – rather than just the accrued unpaid amortization payments – becomes due and payable. Acceleration of a mortgage loan is thus the necessary first step in preparing for foreclosure, enabling the mortgagee to pursue a claim for the full amount owed to it.

The length of time during which the homeowner/mortgagor has a right to cure a default, and thus prevent acceleration of the loan and eventual foreclosure, varies greatly from state to state (for instance, it is less than 30 days in Texas and close to 450 in New York). The time then required to complete the foreclosure process also varies from state to state. It should be noted, too, that special legislation may have been passed in some states to expand the rights of mortgagors-in-default in the wave of home foreclosures that followed the “bursting of the housing bubble” in 2007-2008.

The difference between the judicial foreclosure of a mortgage and the non-judicial foreclosure of a deed of trust can sometimes be significant for a CLT seeking to regain title to a foreclosed property. The Model CLT Lease provides that, in the event a mortgagee takes title to a CLT home through foreclosure, the CLT shall have “an option to purchase the Home and Homeowner’s interest in the Leased Land from the Mortgagee for the full amount owing to the Mortgagee” (such an option is also granted in some specific CLT-mortgagee agreements, including the Fannie Mae Rider). This option is an important opportunity for the CLT. The question, however, is whether the mortgagee will *necessarily* hold title to the home for any period of time when a foreclosure occurs. In title theory states, when a deed of trust gives the trustee the right to auction the home in the event of an uncured default, it is possible for a third party to place a successful bid, with the result that the title never passes through the mortgagee and the CLT will have no post-foreclosure option to purchase.

In most cases, in both title theory and lien theory states, the mortgagee *will* place a bid and take title to the property through the auction. Other bidders are usually bargain-hunters, whose highest bids are likely to be less than the market value of the property and may also be less than the amount owed to the mortgagee. When such is the case, the mortgagee will be motivated to acquire the property in the hope of liquidating it for a higher amount. This will not *always* be the case, however, particularly in situations where the loan has been paid down significantly and/or the market value of the property has appreciated significantly.

At any foreclosure auction the CLT can itself bid on the property – and would be wise to do so as long as it can purchase the property for a price no higher than what will allow the home to be resold on terms affordable for an appropriate income level. However, it should be noted that, whereas the mortgagee can bid at such auction without submitting evidence of credit, any other bidder should expect to be required to demonstrate that it can complete the transaction for the amount of its bid.

Finally it should be emphasized that, even when the CLT does have an option to purchase a home from a mortgagee who has in fact taken title to the home through foreclosure or a deed in lieu, the employees or agents of the mortgagee who are dealing with the matter will not necessarily be aware of this fact. The Model Lease and other documents that convey such an option to a CLT do normally require the mortgagee to give notice to the CLT that title to the property has been acquired and that the CLT has an option to purchase during a period of time beginning with the date of the notice. A failure to give notice to the CLT could undermine the mortgagee's right to convey title to a third party; nonetheless, it is possible for the CLT's rights to go unnoticed by all parties. For this and other reasons, it is important that the CLT communicate as closely as possible with those handling the foreclosure for the mortgagee.

### **Dealing with Non-Permitted Mortgages**

CLTs are normally in position to control the kind of mortgage financing available to a homebuyer at the time of purchase, but it can be difficult for them to screen *subsequent* financing. The current Model CLT ground lease contains special provisions for the screening and approval of subsequent financing that a homeowner may seek for the purpose of either refinancing the original mortgage loan or accessing additional credit through a second mortgage loan. Nonetheless, such loans may still occasionally be made without the CLT's knowledge or permission. When this does happen it is usually the case that the lender was not aware that the permission of the ground lessor was required for any mortgage loan (and may even have been unaware that the homeowner did not hold fee simple title to the property). If a CLT discovers that such a loan has been made, what can it do about the situation?

Assuming that the lease is based on some version of the Model Lease, it is important to understand, first, that in granting a mortgage without the CLT's permission the homeowner has violated terms of the ground lease and is therefore in default under the lease, and, second, that the lease does not give a non-permitted mortgagee those protections that it gives a Permitted Mortgagee. These basic facts should give the CLT a good deal of leverage in dealing with the mortgagee. Even if the mortgage is not in default when the CLT discovers its existence, the CLT (with its attorney) should sit down with the homeowner and mortgagee (and their attorneys) and review the terms of both the lease and the mortgage, with the following questions in mind:

1. Has the homeowner "mortgaged" an ownership interest that he or she did not hold (as will be the case if the mortgage is not a leasehold mortgage)?
2. Does the total amount of debt secured by all current mortgages approach or exceed the current purchase option price?
3. Is the total debt service required by all current mortgage loans affordable for the homeowner?

If the answer to the first question is that, yes, the homeowner has signed a conventional mortgage document that was intended to apply to the CLT's fee interest in the land as well as the homeowner's interest in the improvements, then it may be possible to negotiate a permissible leasehold mortgage to replace it, with terms that are workable for the homeowner and CLT. The mortgagee clearly has an interest in replacing the potentially unenforceable security document.

If the answer to the first question is yes, and the answer to the second question is that the non-permitted mortgage has raised the total mortgage debt to a level exceeding the purchase option price, then it may be possible to negotiate a deal with the mortgagee whereby the CLT agrees to permit a leasehold mortgage for a lesser amount – with the mortgagee accepting the reduced amount in return for the legally enforceable security.

If the answer to the first question is yes, and the answer to the third question is that the homeowner's total debt service is not – or may not be – affordable, then it may be possible to negotiate a permissible leasehold mortgage with a new amortization schedule that will be affordable.

If a non-permitted mortgage is reported to be in default, it will be particularly important for the mortgagee to understand the legal difficulties it would face in trying to foreclose the mortgage and take title to the property. Once the difficulty is understood, it should be possible to work out an arrangement that will resolve the problem of the reported default in a way that will serve the interests of both the homeowner and the CLT.

## **Dealing with Monetary Lease Defaults**

A monetary lease default, as described in Section 12.1 of the Model CLT Lease, occurs when a lessee fails to make payments that the lease requires him or her to make to the CLT. If the CLT has duly notified the lessee of the failure to pay and the lessee then does not rectify (“cure”) the default within the time allowed, then a formal “event of default” has resulted, giving the CLT a right to proceed with termination of the lease and eviction of the lessee.

A number of CLTs have experienced persistent problems in collecting ground lease fees, and some have been frustrated by the fact that the basic recourse of termination and eviction is so harsh that it is rarely employed (at least as long as the lessee continues to occupy the home). Because lessees are aware that termination and eviction are highly unlikely, they may feel less pressure to pay this monthly expense than other expenses, such as mortgage payments and utility bills, where failure to pay has predictable serious consequences. It can therefore be tempting for low-income homeowners to defer payment of these fees from month to month until the accumulated debt becomes a “worst-case” problem.

The total amount owed to the CLT may be increased when other types of obligations are added to the lessee's obligation to pay a lease fee to the CLT. Section 5.7 of the Model CLT Ground Lease allows the total obligation to be increased through interest charged on the unpaid balance. Section 6.4 allows taxes that the lessee is obligated to pay but has not paid to be added to the lease fee. Section 7.4 allows the addition of amounts paid by the CLT to discharge liens against the Home or Leased Land.

Basic concerns and methods related to the collection of lease fees are discussed in Chapter 13, “Establishing and Collecting Fees.” As noted in that chapter, some CLTs

avoid the difficulties of collection by arranging for the homeowners' mortgagees to collect and escrow lease fees as part of the single monthly payment that also covers principal, interest, taxes and insurance costs. Other CLTs, however, choose to forego this convenience because they want to retain the monthly contact with their homeowners that comes with the payment of ground lease fees directly to the CLT. Both Chapter 13 and Chapter 23, "Post-Purchase Stewardship," emphasize the importance of consistent, methodical month-to-month practices that can prevent unpaid fees from accumulating until they become the kind of worst-case situation that is discussed here.

For CLTs dealing with accumulated unpaid fees, two kinds of legal recourse are available, in addition to the possibility of terminating the lease: the CLT can sue in a small claims court to collect the amount owed, and/or, when the home is eventually sold, it can take action to collect what is owed from the proceeds of sale.

**Collection through small claims court.** Such courts have been established by most states to deal with disputes involving relatively small amounts of money (for example, in some states, amounts not exceeding \$15,000) through a relatively simple and economical legal process. The exact nature of the disputes over which such courts have jurisdiction and the exact rules governing the process do vary from state to state, and a CLT should consult its attorney regarding the applicable law of its own state before taking a claim to such a court. However, a primary purpose in establishing such courts has been to simplify the process to an extent that will allow parties to present their own cases without needing to be represented in the courtroom by an attorney.

The dollar amount of unpaid lease fees that a CLT will typically seek to collect will usually fall within the range that a small claims court is authorized to deal with, but, if the homeowner's total debt to the CLT has been substantially increased, for instance by taxes paid by the CLT or by loans from the CLT for home repairs or to cure a homeowner's mortgage default, then the CLT should be sure that the total amount of the debt does not exceed the dollar amount to which the court's jurisdiction is limited. If the total debt does exceed this limit, the court may dismiss the case altogether even if the CLT would have been satisfied to collect that portion of the debt that did fall within the court's jurisdiction.

Most small claims courts encourage the parties to a dispute to seek alternative means of resolution, such as the mediation and/or arbitration processes permitted under most CLT ground leases. Again a CLT should consult its attorney regarding the most appropriate approach. One factor to consider is that decisions by a small claims court can be appealed, whereas decisions by arbitrators generally cannot be appealed.

It is important to note that a small claims court judgment in favor of a CLT's claim does not insure payment of the debt in the same way that, for instance, a judgment against an insurance company does normally insure payment by the company. If a lower income homeowner cannot access the amount in question, then the CLT may focus on securing incremental payment over time. If the homeowner is working and receives a regular paycheck it may be possible to get the court to order that his or her wages be garnered to pay the debt through installments that will not seriously undermine the household's financial stability.

Even if a homeowner does not have the income needed to pay the debt over time, it may still be in the CLT's interest to seek a judgment in small claims court as a legal basis for later collecting the debt from the proceeds of sale when the home is eventually sold

(as discussed below). It may also be that by systematically utilizing the small claims court when the total amount of a lessee's unpaid lease fees reaches a certain threshold, a CLT can increase the likelihood that the basic obligation to pay the fee will be taken seriously by its leaseholders.

**Collection from Proceeds of Sale.** The Model CLT Ground Lease explicitly establishes the CLT's right to collect unpaid lease fees from the proceeds of sale when the lessee's home is eventually sold. Section 5.8 of the Model (2011 version) reads as follows:

“In the event that any amount of payable Lease Fee remains unpaid when the Home is sold, the outstanding amount of payable Lease Fee, including any interest as provided above [Section 5.7], shall be paid to CLT out of any proceeds from the sale that would otherwise be due to Homeowner. The CLT shall have, and the Homeowner hereby consents to, a lien upon the Home for any unpaid Lease Fee. Such lien shall be prior to all other liens and encumbrances on the Home except (a) liens and encumbrances recorded before the recording of this Lease, (b) Permitted Mortgages as defined in section 8.1 below; and (c) liens for real property taxes and other governmental assessments or charges against the Home.”

As is noted in the commentary on this Section 5.8 in Chapter 11-B, the CLT should consult its attorney regarding actions that it may need to take, under locally applicable law, to ensure that the lien is recognized and can be perfected so that the CLT's claim will be fully enforceable at the time of sale.

**Collection upon Termination of Lease.** As noted above, CLTs have rarely sought to terminate a lease as a means of collecting unpaid lease fees as long as the lessee is occupying the home and is otherwise in compliance with the lease. However, the kinds of serious non-monetary defaults discussed below as possible cause for lease termination may be accompanied by failure to pay lease fees or other amounts owed to the CLT. When a CLT does take action to terminate a lease in such situations, the collection of money owed to it will be one of its concerns.

Section 12.4 of the (2011) Model CLT Lease gives the CLT the right to terminate the lease (or exercise its purchase option) if the lessee has defaulted and the default has not been cured in the time allowed. In addition, Section 12.4(a) states:

CLT shall have such additional rights and remedies to recover from Homeowner arrears of rent and damages from any preceding breach of any covenant of this Lease. If this Lease is terminated by CLT pursuant to an Event of Default, then, as provided in Section 7.7 above, upon thus assuming title to the Home, CLT shall pay to Homeowner and any Permitted Mortgagee an amount equal to the Purchase Option Price calculated in accordance with Section 10.9 above, as of the time of reversion of ownership, less the total amount of any unpaid Lease Fee and any other amounts owed to the CLT under the terms of this Lease and all reasonable costs (including reasonable attorneys' fees) incurred by CLT in pursuit of its remedies under this Lease.

For a CLT that has adopted a provision such as Section 12.4(b) of the Model it may be possible to respond to an Event of Default by exercising the purchase option rather than by terminating the lease. In such a case the CLT should be able to subtract the amount owed to it from the purchase option price, as provided by Section 5.8 of the

Model, quoted above. Again, it should be emphasized that a CLT exercising its purchase option should consult its attorney regarding steps that may be needed to perfect the lien described in Section 5.8 (steps that may or may not be needed if the CLT proceeds with termination rather than exercise of the option).

### **Dealing with Nonmonetary Lease Defaults.**

**Nonmonetary defaults by current lessees.** The nonmonetary defaults that may be committed by current lessees include some potentially serious problems. In violation of the lease, a lessee may be causing serious physical damage to a home, or may be failing to repair serious damage from fire or other causes. Or he or she may be dealing drugs or engaging in other criminal activity on the premises. Or a lessee may have moved out of the home and sublet it for a market-rate rent, thus violating the affordable owner-occupancy requirement stated in section 4.5 of the Model. In any of these situations, when serious violations are not “cured” in accordance with provisions such as those contained in Section 12.2 of the Model Lease, a CLT can end its relationship with the lessee through the kind of termination process described in Section 12.4-a of the Model (or through the exercise of the purchase option if the lease contains a provision such as Section 12.4-b of the 2011 Model).

Before taking any action to terminate a lease and evict the lessee, a CLT should be sure to consult its attorney regarding the exact steps that must be taken in order to comply with all applicable laws, including state landlord-tenant law. Unlike earlier versions of the Model Lease, which spelled out such steps more extensively, the 2011 NCLTN Model defers more explicitly to locally applicable law. Section 12.4-a of the current Model states: “CLT may terminate this lease and initiate summary proceedings under applicable law against Homeowner, and CLT shall have all the rights and remedies consistent with such laws and resulting court orders to enter the Leased Land and Home and repossess the entire Leased Land and Home, and expel Homeowner and those claiming rights through Homeowner.”

It should be noted that, in some cases, the legal enforceability of a CLT’s right to terminate the lease in response to serious nonmonetary violations may be undermined by a lease rider or agreement with the lessee’s mortgagee (but the right to exercise a purchase option as provided in section 12.4-b may still stand, as noted below). Some financial institutions will not make leasehold mortgage loans if the terms of the lease can result in termination for nonmonetary violations. Their concern is that, although a mortgagee has the ability to cure a monetary violation, it generally does not have the ability to cure a nonmonetary violation, and could not, by that means, prevent such a violation from resulting in termination. CLT leases do, however, provide other protections for a mortgagee in such situations – including provisions denying the CLT a right to terminate the lease while a permitted mortgagee is pursuing foreclosure and, if it does terminate the lease, requiring it to enter into a new lease with the mortgagee (Sections B-4 and B-5 of the Model Exhibit). These protections should be pointed out to potential CLT leasehold mortgagees in an effort to persuade them that the CLT’s essential right to terminate a lease when important lease provisions are violated should be allowed to stand.

It should be noted that the Fannie Mae CLT Lease Rider (in Section F) prohibits “forfeiture or termination” of the lease for nonmonetary violations *except* for violations

of the important occupancy and resale restrictions. It should also be noted that, although the Fannie Mae Rider does prohibit forfeiture or termination for all other types of non-monetary violations, it does not explicitly prohibit the description of these violations as “defaults” or the provision for exercise of the purchase option described in section 12.4-b of the Model as a remedy. When negotiating the terms of lease riders with other potential mortgagees, CLTs using a lease that includes such a purchase option provision should try to be sure that the language of the rider will not prevent exercise of the option in the event of a nonmonetary violation.

Some CLTs facing mortgagee prohibitions against termination for nonmonetary violations have adopted lease provisions that impose monetary penalties for these violations. To be effective, these penalties need to be large enough so that whatever benefit a lessee may gain from the violation – e.g., profit from subleasing a home for more than the lease permits – is outweighed by the cost imposed by the penalty.

Of course some types of nonmonetary violations of a CLT lease undermine the interests of the mortgagee as well as those of the CLT, and may in fact constitute defaults under the terms of the mortgage. Examples include failure to make necessary repairs to the home, or violations of building codes or other laws. A CLT that is aware of any such violations and has been unable to get the homeowner-lessee to correct them should usually consult with Permitted Mortgagees about possible courses of action that will serve the interests of both the mortgagee and the CLT.

**Nonmonetary defaults by ex-lessees.** Among the most serious types of lease violations that a CLT may discover – if not *the* most serious type – are those involving transfers of the home and leasehold interest in violation of the explicit restrictions on transfer (as spelled out in Article 10 of the various versions of the Model Lease). If such a violation has taken place, the CLT’s recourse is obviously not a matter of terminating the rights of the party that now claims to have transferred those rights to another.

How a CLT reacts to such a situation will depend, first of all, on the details of the purported transfer. Before a CLT takes any legal action it will want to determine the facts of the matter – and in particular who the purported transferee is and what he or she knows about the ground lease. One possibility is that the ex-lessee has “sold” the home without any reference to the ground lease, so that the transferee, being unaware that the home was owned subject to a ground lease and that the seller had no authority to transfer fee simple ownership, may innocently believe that he or she did in fact purchase a fee simple interest. (It is possible in such cases that even the “seller” – perhaps an heir or executor of the original lessee’s estate – was innocently unaware that the land was leased, and on terms that restricted transfers.) It should be noted, however, that such a transaction would be unlikely to involve a conventional mortgage lender, since such a lender will normally require the sort of title work that should bring to light the existence of the lease. If there is a mortgage, it is more likely that it is held by a friend or relative of the buyer.

Another possibility is that the seller has acknowledged the existence of the ground lease but has willfully deceived the buyer (and possibly a mortgagee) by forging the signature of a CLT representative on a document purporting to transfer the lease to the buyer. And, finally, it is possible that the seller has conspired with a knowing buyer to carry out an illegal transfer.

If the CLT determines that, regardless of the motives of the seller, the *buyer* had no intent to defraud and was in fact income-eligible, then the CLT will normally want to meet with that person, review the terms of the lease and determine whether the buyer understands the terms and is willing to sign a “letter of agreement” and enter into a new lease with the CLT. If the person is in fact eligible, informed, and willing to accept the terms, there may be no need for further action – unless the price paid by the buyer exceeded the purchase option price. If the price was in fact higher than the lease permitted, then the seller should be required to refund the excess amount to the buyer. (Even if the buyer was able to afford the higher price, the buyer’s actual investment should be brought back down to the purchase option price at the time of transfer, which will then be the base price to be used in calculating the maximum allowable price at the time of the next resale.) If the seller will not refund the required amount willingly, the CLT will need to consult its attorney regarding the best legal means of compelling payment – perhaps through small claims court as with the collection of unpaid lease fees discussed above.

If the buyer is ineligible and/or unwilling either to accept the terms of the lease or cooperate with the CLT in otherwise resolving the situation, then the CLT must consult its attorney regarding the best way of addressing the problem in order to return the property to its intended use as an affordable home for income-qualified owner-occupants who accept the restrictions on ownership that are established in the lease.

### **When a CLT Is Unable to Sustain its Stewardship Functions...**

The important subject of organizational sustainability is addressed in Chapter 24, with particular emphasis on the sustainability of the CLT’s stewardship functions. Whereas other functions – in particular the acquisition and development of real estate – may be suspended when they cannot be sustained at a given level, a CLT’s stewardship responsibilities cannot be suspended. When acquisition and development work is suspended, the amount of property for which the CLT has stewardship responsibilities will of course cease to grow, but the organization’s responsibility for stewarding the property it already holds will not be diminished. Sustaining the capacity to carry out these stewardship responsibilities in the absence of development activities – thus in the absence of development fees or development-related income of any sort – can be a difficult challenge for a CLT. Chapter 24 suggests ways of coping with the situation. In reality, however, some CLTs may reach a point where they simply do not have, and are not capable of developing, the resources needed to carry out their responsibilities alone.

A CLT that is unable to fulfill its stewardship responsibilities may (or may not) be able to work out a legally defined arrangement with another institution that is better able to provide some or all of the necessary stewardship services. The possibilities for such a CLT will depend not only on the nature of the CLT’s particular stewardship responsibilities and on the particular circumstances responsible for its inability to fulfill these responsibilities, but also on the availability, capacity, and willingness of another nonprofit or governmental entity operating in or near the CLT’s service area. In the discussion that follows we will assume: (1) that the CLT owns real estate that does generate some level of revenue in the form of rents or ground lease fees, but that this revenue is not sufficient to cover the CLT’s administrative and stewardship costs; (2) that the physical condition and net worth of the CLT’s real estate portfolio is such that

another entity might be willing to assume responsibility for it; and (3) that one or more such entities do exist in the CLT's locality or region. The *ultimate worst case* situation is one in which at least some of these assumptions *do not* apply – a situation in which the CLT's financial position may be such that at least some of its real estate will have to be sold to other-than-charitable entities in order to pay creditors, and/or that the CLT may have to declare bankruptcy. Parts of the discussion that follows (in particular the part dealing with dissolution) may be useful to a CLT in certain such situations, but we will not try to offer generalized advice that would be applicable for all such situations.

**Types of stewardship sustainability problems.** Most CLT stewardship responsibilities fall into one or the other of two broad categories: the maintenance and management of affordable rental housing, or the monitoring and support of affordable homeownership on CLT-owned land. For smaller CLTs that do hold rental housing (as a number of neighborhood-based CLTs do), the responsibilities of maintaining and managing a relatively small number of rental properties for the long term can be particularly difficult to handle. The per-unit cost of stewarding smaller numbers of rental units is great (especially in distressed neighborhoods) and may require more resources than a small CLT can command. Furthermore, the demands that rental management makes on whatever resources such organizations do have will make it difficult or impossible for them to expand their rental holdings in order to achieve economies of scale. In effect they are trapped beneath a ceiling that they cannot break through. And, being trapped this way, unable to grow, they may lose credibility and financial support.

CLTs that do not hold rental housing – those whose stewardship responsibilities are limited to monitoring resident-owned CLT homes and providing certain kinds of support for those residents – may not face the particular difficulties faced by those that do have small rental holdings. However, they may face other kinds of problems. They will not have the level of cash flow that even smaller rental programs generate, and they may therefore have more difficulty paying the staff needed to carry out the responsibilities they do have. They will also lack the mortgagable assets that a rental program entails and that a CLT may be able to borrow against when it needs to fund replacements or repairs or other long-term costs. And finally, CLTs that do not operate rental programs may be so focused on expanding the homeownership opportunities they offer that they fail to make realistic plans for carrying out the stewardship responsibilities they are accumulating, which, though less obvious than those entailed by rental management, are still substantial. Thus it is possible that even these CLTs will at some point find themselves looking for help from another institution.

**Legal options.** We will look at five legal processes by which a CLT may involve another institution in carrying out its stewardship responsibilities.

1. *Contract for services from another entity.*
2. *Transfer of real property assets to another entity by a CLT that will continue to exist.*
3. *Merger of with another not-for-profit corporation*
4. *Restructuring as an affiliate of another not-for-profit corporation.*
5. *Transfer of all assets to one or more entities by a CLT that will then be dissolved.*

We will review basic practical and legal considerations involved in each of these approaches. We will also note some potential advantages and disadvantages of each,

though it should be emphasized that the best approach for a given CLT will depend on the particular circumstances of both the CLT and whatever other entities may be involved.

*Contract for services.* A CLT may be able to contract with another entity to carry out some (or perhaps most) of its necessary functions. When it is possible, this may be the simplest and most practical approach for a CLT that is struggling to manage its rental property but is capable of handling certain other responsibilities. The other entity in this case might be a CDC or other nonprofit that already has the necessary staff, equipment and record-keeping systems to manage a larger rental portfolio. Or it might be a local housing authority, or even a for-profit rental management company. For any such entity to be willing to provide rental management service to the CLT, the rental income will usually need to be sufficient to cover the institution's additional expenses (though, on a per-unit basis those expenses can be less than they would be for the CLT). That entity will also want to see that there is a source of funding to cover the capital needs of the property in question. If the CLT has not been able to accumulate sufficient reserves for this purpose, then either there must be sufficient equity in the property to allow borrowing the necessary funds or grant funding must be sought from public or charitable sources.

If the services in question are limited to rental management, then the contract with the other entity may take the form of a common type of rental management contract. In some cases, however, it may be possible for a CLT to contract for other necessary services – perhaps including administrative functions, and perhaps the monitoring of resident-owned homes – from a larger institution that is able to employ qualified, specialized staff on a cost-effective basis. The more comprehensive the terms of such a contract become, the more important it will be to have an attorney's help in addressing the many potential questions regarding who will be responsible for what and who will be liable for what. Apart from the drafting of the contract, however, the contract for services approach does not entail the kinds of legal issues relating to state agencies and the IRS that other approaches may entail.

The major advantage of this approach is that it is a relatively straightforward process through which a CLT may be able to fulfill its responsibilities while continuing as an independent organization and retaining ownership of its real estate holdings. It also has the advantage that it can be terminated, or its terms modified, if the CLT finds it is not working as intended. The major disadvantage is that, on a day-to-day basis, a separate entity is inserted between the CLT and its constituents (tenants and perhaps ground lessees) and may not be as responsive to those constituents as the CLT would like.

*Transfer of real property assets by a CLT that will continue to exist.* While continuing to operate as an independent organization, a CLT may transfer ownership of some or all of its real estate to one or more entities. A CLT might, for instance, transfer all of its rental property to another entity with existing rental management capacity while continuing to own and steward land beneath owner-occupied CLT homes. Or it might choose to transfer all real property assets while continuing to operate other programs such as housing-related training programs or neighborhood planning and advocacy programs. In any transfer of property, the CLT will be concerned with seeing that the transferee has both the capacity to carry out necessary stewardship functions and a commitment to doing so for the long term.

In any such transactions, the transferee will need to accept responsibility for all mortgage debt secured by the transferred properties, and will need to agree to use the properties in accordance with the terms of any subsidies invested in them. And the holders of all such mortgages and the sources of all such subsidies will have to consent to the transfers in question. The legal work required to see that all responsibilities are formally transferred and that all necessary parties have given written consent may take time and may entail significant expense. The CLT will need to work closely with its attorney to complete the process,

The primary advantage of this approach is that, while retaining the ability to carry out certain functions such as educational, planning, and advocacy activities, the CLT is able to pass on to a more qualified institution a set of stewardship responsibilities that it does not have the capacity to carry out. The primary disadvantage is that, unless the transferee is itself a CLT with a proven track record, it will be hard to be sure of the long-term capacity and commitment of that institution (whose bylaws are unlikely to contain the kinds of permanent stewardship requirements that are typical of CLT bylaws). It should also be emphasized that the legal process entailed by this approach is much more extensive and complicated than what is entailed by a contract for services.

*Merger with another not-for-profit corporation.* A CLT may arrange to merge its assets, liabilities and corporate identity with those of another 501(c)(3) charitable corporation, on terms and conditions agreed to by both parties. In recent years a variety of nonprofit housing organizations have merged with others. Some of them have been relatively strong organizations seeking to gain further strength and sustainability through economies of scale. Others have been facing worst-case situations where they were unable to carry out basic stewardship responsibilities alone.

A merger effectively terminates the legal existence of one of the two corporations (the “disappearing” corporation), which is absorbed into what is deemed the “surviving” corporation, even if the terms of the merger include changing the survivor’s name. A CLT could enter into a merger as the surviving corporation, but if the CLT is a relatively weak organization merging with a stronger one it may be that the merger will mean the termination of the CLT’s corporate existence. Even in this case, however, the features of the surviving corporation – including the composition of the board of directors, officers, and staff – are matters to be negotiated and established by the parties in a written merger agreement.

For whatever plan is agreed upon, the CLT will need to identify, with its attorney, the mortgagees and subsidy sources with an interest in its properties that will need to consent to the transfer or redefinition of ownership that the merger will entail.

Unless merging with an entity that is not a 501(c)(3) charitable corporation (which would raise a number of concerns and should normally be avoided), a “disappearing” CLT may only need to notify its state’s Attorney General’s Office of the merger before the “surviving” 501(c)(3) corporation files the merger agreement with the state’s Department of State and duly notifies or reports to other state agencies as necessary. In any case a final federal 990 tax return will need to be filed for the CLT as of the time of the merger.

The merger can be a good way of addressing CLT sustainability problems when there is an appropriate organization to merge with. A merger of two CLTs serving adjacent territories, for instance, can be a way for both to increase their sustainability without

substantially compromising their (presumably similar) missions. For a CLT exploring merger possibilities with a different sort of nonprofit – perhaps a more conventional sort of housing organization or CDC – one crucial question will be how willing that organization is to accommodate the CLT’s mission, governance principles, and client relationships. Obviously, the more dissimilar the two organizations are the more problematic a merger will be. The task of negotiating and implementing any merger will necessarily require much work and much time. It is also likely to involve some painful personnel decisions as the two organizations become one.

*Restructuring as an affiliate of another not-for-profit corporation.* While retaining a separate identity and board of directors, a CLT may be restructured (under new or revised bylaws) to give another nonprofit corporation some degree of control over it. The most extreme form of restructuring can establish the other organization as the sole “member” of the CLT with the right to appoint all members of the CLT’s board – the CLT thus becoming, in effect, a “subsidiary” of the other organization. Classic CLTs, with their very different and distinctive membership structures, will normally want to resist giving up this much control over their board composition. However, a CLT that has stopped growing, and therefore no longer experiences the excitement of new projects, can find it difficult to sustain enough energy at the board level to support effective governance. This sort of loss of momentum can be self-perpetuating. At a certain point, a subsidiary relationship with a stronger organization may be the best way for such a CLT to see that necessary stewardship activities will continue to be carried out.

For CLTs less in need of a major infusion of new leadership, a less extreme form of restructuring may be appropriate. In such cases another organization may be given a certain number of seats (ranging from one to a majority) on the CLT’s board while other seats continue to be reserved for constituent-elected representatives.

Any form of structural affiliation can be accompanied by a contract for services, as discussed above, so that the other organization can provide a significant degree of staff support to the CLT – and can thereby have a significant degree of control in the hiring and supervision of staff as well as in the selection of board members.

Of course there are also other potentially important forms of affiliation that do not involve any degree of subordination of one organization to another but that provide a formal mechanism for collaboration and mutual support. Local community development alliances and regional networks are examples of this kind of affiliation.

*Dissolution with distribution of all assets.* This approach will involve all of the actions and issues noted above for a CLT that will transfer some major assets but will continue to exist, plus the actions and issues involved in dissolving the CLT corporation. It can be a reasonably satisfactory response to an unsustainable situation when there is at least one nonprofit or governmental entity that will take ownership of the CLT’s housing assets and will have the capacity to steward them in keeping with the CLT’s original intent. In the absence of such entities, the situation is indeed a worst case – a situation in which the CLT must focus on distributing its assets in a way that will do as little harm as possible to residents, funders, and other affected parties.

Needless to say, if a CLT is to be dissolved, all of its assets *must* be transferred to someone or some entity. For a CLT that is forced to plan the distributions of its assets, it is important, first of all, to be clear about what is required and what is permitted by (a) federal law for 501(c)(3) organizations, (b) the CLT’s own bylaws, (c) the ground leases

for owner-occupied homes on CLT land, (d) subsidy sources, and (e) state laws re. corporate dissolution.

- *501(c)(3) requirements.* For a nonprofit corporation to qualify for 501(c)(3) status, its articles of incorporation must state that in the event of dissolution all of its remaining assets, after payment of all expenses, shall be distributed to another 501(c)(3) organization or a government entity. This does *not* mean, however, that CLT property – including CLT land – cannot be sold to other types of buyers as the CLT prepares for dissolution. As far as the tax code is concerned, the land beneath a CLT homeowner’s home can be sold to the homeowner, for a below-market price if the sale serves the charitable purpose of the overall homeownership program, or, otherwise, for a market price. In fact, the land, as well as other assets, may be sold to *any* party for a *market* price, with the proceeds then being used to pay the organization’s debts and with any remaining proceeds distributed to another 501(c)(3) or government entity.
- *CLT bylaws.* Bylaws vary, so be sure you know exactly what your CLT’s bylaws say about the sale of land and the dissolution of the corporation. Bylaws based on the “Model Classic CLT Bylaws” presented in Chapter 5-A call for a special process to authorize any sale of CLT land. Article VI, section 3, of the Model states: “The sale of land does not conform with the philosophy and purposes of the Corporation. Accordingly, land shall not be sold except in extraordinary circumstances, and then only in accordance with the following guidelines.” The guidelines require approval by at least two thirds of the *entire* board of directors *and* two thirds of the members in a membership meeting at which a quorum has been assembled.” Article IX of the Model requires the same two-thirds approval by board and membership for a decision to dissolve the corporation. It is possible that a badly weakened and perhaps paralyzed organization will find it difficult if not impossible to assemble the necessary numbers of directors and members to achieve approvals on these terms. In such a case you should consult your attorney regarding possible alternative means of proceeding under the laws of your state.
- *Ground lease requirements.* Section 3.3 of the Model CLT Lease contains two provisions that provide crucial protection for the homeowner in any situation where the leased land is to be transferred. First, the section states, “If ownership of the Leased Land is ever transferred . . . to any other person or institution, this Lease shall not cease, but shall remain binding on the new land owner as well as the Homeowner.” Secondly, the section states that, “if the CLT agrees to transfer the Leased Land to any person or institution other than a non-profit corporation, charitable trust, government agency or other similar institution . . . , the Homeowner shall have a right of first refusal to purchase the Leased Land” for the price agreed upon between the CLT and the third party. Note, however, that nothing in the lease prohibits a CLT in this situation from offering the land directly to the Homeowner for any price.
- *Funder requirements.* It is common for CLTs to enter into written agreements with the sources of subsidies (whether the subsidy is structured as a grant or deferred loan). If the CLT ever seeks to transfer ownership of subsidized property (or otherwise fails to comply with the terms of a funder agreement), the subsidy source commonly has a claim either on the dollar amount of the subsidy or on the

subsidized property itself. A CLT contemplating dissolution should meet with such funders, should determine exactly what requirements will apply to the distribution of property subsidized by each funder, and should seek approval for any planned distribution of subsidized property to other parties subject to the subsidy agreement.

- *State legal requirements.* State laws regarding corporate dissolution vary in their details, and the guidance of a local attorney will be essential. Before taking any steps, the CLT should gain a clear understanding of exactly what steps must be taken, with what state agencies, in what order. In most states, an organization pursuing dissolution will need to notify its state's Attorney General's Office and get a written waiver of objections to its plan for liquidating and distributing its assets before notifying its creditors of its plan to do so (but should discuss the plan with subsidy sources *before* notifying the AG's office). In completing the process, the organization will typically also need to deal with its state's Department of State and perhaps other state agencies involved in overseeing tax-exempt organizations. And finally the CLT must disclose its dissolution to the IRS by filing its final 990 report.

In some cases it may be possible for a CLT to turn over all of its assets to a single nonprofit or governmental entity that will be capable of employing the CLT's real estate and other assets in ways consistent with the CLT's mission. When the recipient is a nonprofit the arrangement could be quite similar to a merger in which the CLT is the "disappearing corporation." In such case, the CLT may try to negotiate an agreement whereby the recipient nonprofit will appoint some of the CLT's directors to its board and/or hire some of the CLT's staff.

It is also possible that a CLT may distribute its assets to two or more nonprofit or governmental entities – for instance transferring rental properties to a municipal housing authority or nonprofit rental program while transferring land beneath owner-occupied homes to a separate governmental or nonprofit homeownership program. In such cases the CLT will probably want, after paying all debts, to distribute any remaining current assets to one or more of the recipients of the CLT's real estate to help support ongoing stewardship functions.

**Research and due diligence re. potential partners or transferees.** Organizations that are struggling to survive may not have the time and resources needed to perform all of the research and document reviews that would ideally be called for. Nonetheless, a CLT that is considering turning over significant property and/or control to another organization must do all that it possibly can to be sure that the organization really has the capacity to provide what the CLT is seeking. Even if the CLT has known, and perhaps worked with, the other organization for many years, it should check a number of things methodically, and with professional help where appropriate and possible.

Up-to-date financial reports will of course be crucial. The CLT should ask the organization for both audited financial reports and copies of federal 990 reports for recent years, as well as internal reports covering whatever time has elapsed since the most recent audit. If the CLT does not have enough financial expertise among its own personnel to complete a meaningful analysis of these documents, it should seek help from someone outside the CLT, such as someone with experience as CFO of another nonprofit housing program. Depending on the nature of the organization's programs and

on what questions are raised by the basic financial reports, the CLT should be prepared to ask for more detailed financial information in certain areas (e.g. financial performance of rental properties). Today's accounting software usually makes it possible to generate a number of specialized reports when they are asked for. The goal in a financial review of this sort is not only to gather essential information but to gauge the organization's ability to understand and manage its own finances.

Knowledge of the organization's personnel is also crucially important. The CLT should request an up-to-date board list (which can also be found in the 990), and if a significant number of board members are not known to at least a few CLT personnel, then the CLT should make an effort to meet as many members as possible. The qualifications of the organization's staff are even more important. If staff are not already known to CLT personnel, a meeting or meetings should be arranged. And resumes should be requested.

Equally important will be first-hand observation of the current condition of real estate that the organization owns and/or manages or otherwise stewards. In the case of any rental housing that the organization manages, the CLT should ask to see the interior as well as exterior of at least some buildings.

Due diligence should also include a review of the following.

- Corporate documents (articles of incorporation, bylaws, and any amendments to either).
- Minutes for board and membership meetings for at least the past year (with attention to whether meetings are held and decisions are made in compliance with the organization's bylaws)
- Evidence of tax status (application for 501(c)(3) status, IRS determination letter, and recent 990 reports).
- Grant and loan agreements (with attention to restrictions and conditions).
- Reports to grantors.
- Insurance policies.

## A GLOSSARY OF CLT-RELATED TERMS

- 501(c)(3) status**, status as an organization that is recognized by the IRS as exempt from federal income tax under Section 501(c)(3) of the Tax Code. Achieved by most CLTs, it is the most advantageous type of federal tax exemption because donations to an organization with such status are tax-deductible for the donor. (see Chapter 6.)
- alienation**, the transfer of title to property from one party to another. See *restraints on alienation*, below.
- amortization**, the paying off of the principal of a debt, with interest, over time, usually through payments of a regular amount at regular intervals (e.g., monthly).
- appraisal**, determination of the fair market value of real property by a professional appraiser applying standardized methods.
- appraisal-based formula**, a common type of CLT resale formula that allows the resale price of a home to increase beyond the *base price* by a specified percentage of any increase in the home's value as measured by *appraisals*. Three types of appraisal-based formulas are distinguished: *improvements-only appraisal-based* formulas, *simple appraisal-based* formulas, and *compound appraisal-based* formulas. (See Chapter 12.)
- appreciation**, increase in the value of an asset such as real estate.
- appurtenant rights**, property rights that are attached to the ownership of a specific piece of *real property*. (For instance, an easement right of access from the specific parcel of land to a nearby street, granted so as to benefit any owner of that land, would be an appurtenant right to the land.)
- arbitration**, a formal process outside of the court system designed to settle a dispute between two parties through the appointment of one or more "arbitrators" who hear evidence and decide how the dispute should be resolved. (Article 13 of the 2011 Model Ground Lease allows an arbitration process to be used to resolve disputes between Lessor and Lessee.)
- area median income (AMI)**, the median household income in a particular metropolitan statistical area (MSA) or county, as calculated and adjusted for household size by HUD.
- articles of incorporation**, the charter document establishing the existence, purposes, and general powers of a *corporation* as a legal entity when accepted for filing by a state.
- assessment**, the determination of the value of a piece of property for the purpose of calculating property taxes. Assessed value is related to but not necessarily the same as "market value" as determined by *appraisals*. (See Chapter 17.)
- assignment**, the transfer of specific rights (or of a document bestowing those rights) to a certain party. A CLT ground lease (and the leasehold interest that it bestows) can be assigned by the lessee to another party only with the permission of the CLT.
- base price** (as used in stating *resale formulas*), the price that a homeowner has actually paid for the home, including the downpayment and the principal amount of the first mortgage but excluding any mortgage loans that the homeowner is not required to repay; distinguished from *settlement price*. (See Chapter 12.)
- board of directors**, a group of elected or appointed individuals who are collectively empowered to make major decisions for a *corporation* (either for-profit or not-for-profit), within guidelines established by the corporation's *bylaws*. Also called "board of trustees."
- bylaws**, the duly adopted rules governing how an organization carries out the purposes and powers set out in its *articles of incorporation*. Bylaws deal with matters such as the rights

and responsibilities of the members (in a *membership organization*), the *board of directors* and the *officers*, and the processes to be followed in holding elections, conducting meetings, etc. (See Chapter 4.)

**closing**, completion of a transaction conveying real property from one party to another through the signing of documents such as deeds, mortgages, ground leases, etc. evidencing the conveyance. (See Chapter 22.)

**closing costs**, final payments made by the parties to a real estate transaction at the time of closing. Typically included are such payments as legal fees, title insurance fees, recording fees, loan origination fees, property taxes, and real estate transfer fees.

**Community Housing Development Organization (CHDO)**, As defined within the regulations of the federal *HOME program*, a CHDO is a tax-exempt nonprofit organization that has among its purposes the provision of decent housing that is affordable to low-income and moderate-income persons and that maintains its accountability to low-income community residents by reserving at least one-third of its governing board's membership for residents of low-income neighborhoods, other low-income community residents, or elected representatives of low-income neighborhood organizations. Under the HOME program, at least 15% of a Participating Jurisdiction's annual grant must be invested in programs or projects sponsored by CHDOs. The 1992 Housing and Community Development Act defines CLTs as a variety of CHDO, while exempting new CLTs from the requirement that an organization must have a "demonstrated capacity" to develop affordable housing and a "history" of serving its community before it can be designated a CHDO.

**Community Reinvestment Act**, federal legislation, enacted in 1977, that holds federally regulated banks responsible for meeting the credit needs of the communities in which they do business, including low-income communities.

**compound appraisal-based formulas**, a type of *appraisal-based formula* that allocates to the seller a specified percentage of the market appreciation of that portion of the combined value of land and improvements that the seller originally paid for through the *base price*. (See Chapter 12.)

**condominium**, a building or set of buildings in which *condominium units* are individually owned while certain common elements are owned collectively by the unit owners. (See Chapter 14.)

**condominium association**, an association of condominium unit-owners, which governs the use and management of common elements within a condominium.

**condominium unit**, an individually owned unit in a multi-unit building or complex. The owner holds sole title to the airspace occupied by the unit plus an undivided interest, with other unit owners, in the common elements of the complex.

**construction loan**, a short-term loan to finance the construction of real estate improvements.

**cooperative (coop, or co-op)**. A housing cooperative is a *corporation* owned and controlled by a membership consisting of the occupants of housing owned by the corporation. Each occupant holds a share in the corporation and a "proprietary lease" from the corporation for the unit she occupies. In the case of a market-rate coop, an occupant can sell her share and proprietary rights for whatever amount the market will bear. In the case of a *limited-equity coop*, the amount that she can receive is limited by the coop's bylaws in order to preserve the affordability of the unit. (See Chapter 15.)

- corporation**, a legally established entity whose rights of doing business are in most respects the same as those of an individual. For-profit corporations are owned and controlled by those who hold stock in the corporation. *Not-for-profit corporations* are controlled by members, who are not stock-holders. (See chapter 3.)
- corporate purposes**, the purposes for which a *corporation* has been established, as formally stated in the *articles of incorporation*. The corporate purposes are an important consideration for those establishing a new not-for-profit corporation. (See Chapter 3.)
- cure** (to cure a default), to remedy the failure (e.g., failure to make required payments) that has resulted in the default, thereby eliminating the condition of default. See *default*, below.
- debt service**, periodic payment – typically a monthly payment – on a mortgage or other loan. These payments usually include *amortization* of a certain amount of principal plus interest to date.
- deed**, a written instrument that, when signed by the *grantor(s)* and delivered to the *grantee(s)*, conveys title to, or an interest in, real estate.
- deed in lieu of foreclosure**. When otherwise unable to avoid foreclosure, a homeowner/mortgagor may give the holder of the mortgage “a *deed* [to the mortgaged property] in lieu of foreclosure.” By thus avoiding foreclosure, the homeowner avoids a blight on his or her credit history, and the lender takes title to the collateral without the expense of foreclosure.
- deed of trust or mortgage deed**, a type of *mortgage* whereby the borrower conveys title conditionally to the lender, who holds it in trust as security for the loan. Whether a state uses a *mortgage* or a *deed of trust* is often a matter of the history of the property law in the particular state. Both are effective ways to give a lender security for a loan. See *mortgage*; also see *title theory state*.
- deed restriction or deed covenant**, or “covenant that runs with the land,” a provision written into or attached to a *deed*, whereby the rights being conveyed to the grantee are limited in specified ways. (See Chapter 8.) CLTs sometimes use deed restrictions, rather than ground leases, to establish restrictions on the occupancy and resale of condominium units. (See Chapter 14.)
- default**, failure to meet a financial obligation or otherwise comply with the terms of an agreement.
- deferred loan**, a loan that the borrower is not required to repay for a specified period of time or until a specified event. Affordable housing *subsidies* are often structured as deferred loans (typically payable or assumable when the subsidized home is resold) rather than as outright grants. (See Chapter 19.)
- demise**, to grant or transfer property by a will or a *lease*. (Used in Article 2 of the ICE Model CLT Ground Lease, but not in the current NCLTN Model.)
- disinvestment**, the process by which the value of real estate in a given locality is diminished in the absence of sufficient “reinvestment.”
- dissolution**, the termination of a corporation, accompanied by the distribution of its assets after all debts are paid. To qualify for *501(c)(3) status*, organizations must place strict limitations in their articles of incorporation on the distribution of their net assets upon dissolution. (See Chapters 3 and 6.)

- downpayment**, equity investment that is made by the buyer of real property at the time of purchase. In the purchase of owner-occupied homes, the minimum downpayment required of the prospective homebuyer typically ranges from 10% to 5% or sometimes 3% of the property's purchase price. In some cases "downpayment assistance" programs may cover some portion of the required amount.
- eminent domain**, the right of a governmental or quasi-public body to acquire property for public use through court action, with compensation to the owner determined by the court.
- equity**, the value of property above and beyond any debt secured by the property.
- equity limitation**, the practice of limiting the amount of equity that can be claimed by the owner of a property, by establishing restrictions on the price for which the property can be sold, or, if the property is sold for an unrestricted market price, by requiring the seller to pay a part of the proceeds to a sponsoring governmental or nonprofit entity.
- equity-limitation formula**. See *resale formula*.
- Equity Trust, Inc.**, the national organization established by the late Chuck Matthei (previously Executive Director of *ICE*) to promote models of limited equity ownership and community investment. When *ICE* transferred its loan fund to the National Housing Trust and ceased to exist as an independent organization, it transferred the rights to its technical publications to Equity Trust, Inc., which shares those rights with the National CLT Network.
- execution**, the signing and delivery of a legal instrument.
- exercise**, to take an action that one is entitled to take as the holder of a particular right, often by giving a written notice to another party, as in the exercise of an *option* or *right of first refusal*.
- expiration**, the conclusion of a specified period of time, or the retirement of rights granted only for a specified period of time, as in the expiration of a lease. Distinguished from *termination* (see below).
- fair rental value**, the amount of rental income that a given property can be expected to generate for a given period of time in given market conditions.
- Fannie Mae** (Federal National Mortgage Agency), a federally chartered, shareholder-owned corporation that purchases mortgages on the *secondary market*, with funds raised by issuing "mortgage-backed" bonds. Fannie Mae policies allow for purchase of CLT leasehold mortgages on certain terms. (See Chapter 20.)
- Fannie Mae Rider** (Fannie Mae Uniform CLT Ground Lease Rider), a document which, when attached to a CLT ground lease, somewhat modifies the terms of the lease to ensure that they are acceptable to Fannie Mae as a potential mortgagee. (The current Fannie Mae Uniform CLT Ground Lease Rider is presented in Appendix E.)
- fee simple ownership**, the maximum possible set of rights to real property on a permanent basis.
- fee interest**, a conventional ownership interest. In the case of the CLT's ownership structure, the fee interest is held by the CLT while a *leasehold interest* is held by the ground lessee.
- FHA/Federal Housing Administration**, a division of the U.S. Department of Housing and Urban Development that insures high loan-to-value (low-down-payment) mortgages.
- fixed-rate formula**, a resale formula that allows the *resale price* to increase by the annual application of a fixed rate of "interest" to the *base price*.

- foreclosure**, the legal procedure, when a borrower has defaulted, whereby the borrower's ownership of property used to secure the debt is terminated by the lender, usually by a public sale or auction, to provide for repayment of the debt to the lender. (See also, *deed in lieu* of foreclosure.)
- formula price** (in the Model CLT Ground Lease), the potential maximum *resale price* that is determined by the *resale formula*. The *purchase option price* is then the lesser of the formula price or appraised value. See Model CLT Lease, Article 10, and related commentary (Chapters 11-A and 11-B).
- Freddie Mac**, similar to Fannie Mae (above), a federally chartered, shareholder-owned corporation that purchases mortgages on the secondary market, with funds raised by issuing "mortgage-backed" bonds.
- gentrification**, a term coined in the 1960s to describe the process by which inner-city neighborhoods that have undergone disinvestment and decline begin to experience reinvestment, accompanied by the in-migration of a relatively affluent population and the displacement of the lower-income population that had been the neighborhood's former inhabitants.
- grantor**, one who transfers something of value to another (with or without compensation).
- grantee**, one to whom something of value is transferred (with or without compensation).
- ground lease**, a lease whereby the right to use and possess a parcel of land is transferred from the owner of the *fee interest* in the land (the *lessor*) to another party (the *lessee*) for a limited (but often lengthy, such as 99-year) period of time. Usually a ground lease provides for outright ownership of *improvements* on the land by the lessee.
- ground lease fee** or **ground rent**, the amount of money that the ground *lessee* is obligated by the terms of a *ground lease* to pay to the ground *lessor* for the use of the leased land. Usually paid on a periodic basis (e.g., monthly, quarterly or annually).
- HOME program**, a federal program administered by the Department of Housing and Urban Development, providing block grants to states and qualifying municipalities for use in developing or sponsoring affordable housing. Also see *Community Housing Development Organization*, above.
- HUD**, U.S. Department of Housing and Urban Development.
- improvements**, (1: when applied to *real estate*) buildings and other permanent products of human effort that increase the usefulness or value of a parcel of land; (2: when applied to buildings) additions to or modifications of the structures that increase their value, as distinguished from replacements and repairs that replace but do not increase value.
- improvements-only appraisal-based formulas**, a type of *appraisal-based formula* that allocates to the seller a specified percentage of the appreciated market value of only the improvements (excluding land value). (See Chapter 12.)
- income-qualified** (person or household), a person or household qualifying for certain benefits on the basis that the income of the household is below a certain threshold (usually defined as a percentage of *area median income* as adjusted by *HUD* for the particular household size).
- incorporation**, the legal process of creating a *corporation*. (See Chapter 3.)
- indexed formula**, a type of resale formula that allows the resale price to increase beyond the base price in proportion to changes in a specified index, such as a consumer price index or area median income. (See Chapter 12.)

**Institute for Community Economics (ICE)**, the national organization that developed and promoted the CLT model and that developed and published the “Community Land Trust Legal Manual,” (including the original Model CLT Ground Lease). ICE transferred the rights to this published material to *Equity Trust, Inc.* when ICE ceased to exist as an independent organization. Equity Trust, Inc. shares these rights with the National CLT Network, which has revised and expanded the contents of the CLT Legal Manual as the present “CLT Technical Manual.”

**itemized formula**, a type of resale formula that determines the maximum resale price of a property by adding to or subtracting from the base price such specific factors as the value of improvements made by the owner and/or annual depreciation. (See Chapter 12.)

**land** (as property), a space including the surface of the earth and extending downward to the center of the earth and upward infinitely into space.

**lease**, a contract between a landlord (*lessor*) and a tenant (*lessee*) transferring the right to use and possess the landlord’s property to the lessee for a specified period of time and for specified compensation.

**leased fee**, the ownership interest retained by a *lessor* after transferring a *leasehold interest* to a *lessee*.

**leased premises**, the specific *real property* (which could be land, a portion or all of a building, or both) the use and possession of which is conveyed by a *lessor* to a *lessee*.

**lease fee**, see *ground lease fee* above.

**leasehold estate**, or **leasehold interest**, the ownership interest or bundle of rights conveyed by a *lessor* to a *lessee* for the term of the lease. CLTs usually describe the CLT homeowner as holding a *leasehold interest* in the land and a *fee interest* in the improvements. In describing *leasehold mortgages*, however, lenders and appraisers normally define the leasehold estate as including the *improvements*, regardless of whether the lessee owns the improvements outright.

**leasehold mortgage**, a mortgage on the *leasehold estate*, including the *improvements* (see above).

**lease rider**, See *rider*, below, and *Fannie Mae Rider* above.

**lessee**, the party to whom a *leasehold interest* is conveyed by a *lessor*. In the 2011 Model CLT Lease, the lessee is identified as the “homeowner.”

**lessor**, the party who conveys a *leasehold interest* to a *lessee*. In the 2011 Model CLT Lease, the lessor is identified as the “CLT.”

**letter of (attorney’s) acknowledgment**, a letter attached to the CLT ground lease, signed by an attorney and stating that the attorney has explained to the lessee the ground lease and other documents relating to the lessee’s purchase of a home from the CLT. (See Article 1 of the Model Lease and related commentary)

**letter of agreement** or **letter of stipulation**, a letter attached to the CLT ground lease, signed by the lessee and stating the lessee’s understanding of and agreement with the goals, terms, and conditions of the ground lease. (See Article 1 of the Model Lease and related commentary.)

**lien**, a creditor’s right to have a specific debt paid out of the proceeds of sale of specific property owned by a debtor, or otherwise through the action of a court. The term is also used to identify the property interest that a creditor has in the specific property securing such debt repayment.

- lien theory states**, states in which a *mortgage* is treated as being a *lien* on the mortgaged property – the *mortgagee* having no right of possession unless the *mortgagor* defaults and the lien is foreclosed. Distinguished from *title theory states*, below.
- limited equity coop**, the type of housing *cooperative* in which the resale value of ownership shares is limited by the corporation’s *bylaws*. (See *Chapter 15*.)
- loan-to-value ratio**, the ratio (expressed as a percentage) of the amount of a loan to the value of the collateral that secures it. If a home valued at \$100,000 is mortgaged to secure an \$80,000 loan, the loan-to-value ration is 80%.
- mechanic’s lien**, a *lien* created to secure the amount owed to one who has performed work or supplied materials in the construction or repair of the debtor’s property.
- membership organization**, a nonprofit corporation in which members (beyond just the members of the board) have a degree of control over the composition of the governing board, and may be assigned other powers as well. In the case of the “classic CLT,” both *lessees* and non-lessees can become members and participate in electing the CLT’s board of directors. Other powers usually assigned to members of a classic CLT include establishment of member dues and ratification of any plans for the sale of land or *dissolution* of the corporation and any changes in *articles of incorporation*, *bylaws*, and *resale formulas*.
- memorandum of lease** or **notice of lease** or **short form lease**, a document that is filed in the land records of a jurisdiction to record the fact that a particular property is encumbered by a *lease*. The memorandum notes certain major features of the lease but does not contain the amount of detail contained in the lease itself. (See Model Lease, Section 14.12; also the sample notice of lease contained in the Appendix.)
- merger** (of leasehold and fee estates), the action by which, upon the *expiration* or *termination* of a lease, the *leasehold interest* and the *leased fee* are legally combined to create a single *fee simple* interest.
- mineral rights**, the right to mine or otherwise remove minerals from beneath the surface of a given parcel of *land*; may be held separately from other ownership rights to that parcel; Normally retained by the ground *lessor* in the case of a CLT ground lease. (See Model Lease, Section 2.2.)
- monetary default**, failure to meet a monetary obligation; e.g., failure to make mortgage payments or lease fee payments. Distinguished from *non-monetary default*, below. (See Model Lease, Section 12.1.)
- mortgage**, a pledge (in the case of a mortgage *lien*) or conditional transfer (in the case of a *deed of trust*) of real estate as security for a loan.
- mortgage-based formula**, a type of *resale formula* that determines the resale price by calculating the total amount of mortgage debt that could be amortized (at interests rates current at the time of resale) with monthly payments that would be affordable for a given household income. (See *Chapter 12*.)
- mortgage deed**. See *deed of trust*.
- mortgage insurance**, insurance that will cover a certain percentage of a *mortgagee*’s loss due to a *default* by the *mortgagor*. Such insurance may be provided by either a private company or a public source such as FHA.
- mortgagee**, holder of a *mortgage* or (*deed of trust*) as security (whether as the original lender or as a subsequent holder of the mortgage).

- mortgagor**, a property-owner who mortgages (pledges or conditionally transfers) her property as security for a loan.
- non-monetary default**, failure to comply with non-monetary obligations established by a mortgage, lease, or other agreement, e.g., violation of the occupancy requirements established by a CLT ground lease. (See Model Lease, Section 12.2.)
- not-for-profit (or “nonprofit”) corporation**, a *corporation* that is controlled not by holders of ownership shares but by members. Though members may benefit in certain ways from the activities of a not-for-profit corporation, profits generated by those activities cannot be distributed to members as they can be distributed to shareholders in a for-profit corporation. The members may be numerous, as in the case of a classic CLT, or may be limited to the members of the board of directors or even to a single separate entity.
- notice**, a formal notification that is required if due process is to be followed in certain circumstances. For instance, members of a *board of directors* must receive notice of board meetings if decisions made in those meetings are to be legally binding.
- officers**, positions within a corporation to which specific duties are assigned – the most common nonprofit corporate officers being President, Vice President, Secretary, and Treasurer.
- option** (purchase option), a right to purchase a specified property on specified terms, within a specified period of time or upon the occurrence of specified circumstances.
- permitted mortgage** (as the term is used in the Model CLT Ground Lease), a *leasehold mortgage*, securing a loan to the homeowner/lessee, that is explicitly permitted by the CLT/lessor. (See Model Lease, Section 8.1)
- personal property** or **personalty**, movable property that is not a part of or affixed to the *land*; distinguished from *real property* or *realty*.
- portfolio**, a collection of investments held by a single investor. For a mortgage lender, the mortgages retained “in portfolio” are those mortgages not sold on the secondary mortgage market. A CLT’s portfolio is generally understood to consist of its real estate holdings.
- portfolio income**, as used in this manual, income generated through a CLT’s ongoing stewardship activities related to its real estate holdings; includes rental income, ground lease fees, and transfer fees. (See Chapters 23 & 27.)
- power of attorney**, written authorization to take legally binding actions on behalf of another.
- preemptive option**, an *option* to purchase specified property at any time it is placed on the market by its owner, thus a right to preempt a sale to any other party.
- premises**, the surface of a parcel of *land* together with the *improvements* on that parcel of land.
- private mortgage insurance (PMI)**, *mortgage insurance* provided by a private company, distinguished from similar insurance provided by public sources such as *FHA*.
- purchase contract**, a contract between a designated buyer and seller, spelling out the terms on which a specified property is to be purchased by one from the other. Purchase contracts for CLT homes may be three-party contracts, in which the CLT participates as the designated buyer’s ground lessor. (See Chapter 22.)
- purchase option price**, the price at which one has a right to purchase a specified property under the terms of an *option* agreement. In the Model CLT Ground Lease, the purchase option price is the lesser of the *formula price* or appraised value at the time of sale. (See Model Lease, Article 10.)

- real estate**, land and all things permanently attached to it whether naturally or artificially.
- real property** or **realty**, *real estate* as property.
- recording** (of deeds, mortgages, etc.), the process of creating a permanent public record of ownership interests in real estate by filing copies of the documents that establish such interests in the “land records” maintained by an agency of local government.
- resale**, in the context of this manual, any sale of the *improvements* on CLT land after the initial sale to the initial ground *lessee*.
- resale formula**, a formula determining the maximum price for which a specified property can be resold under the terms of a specific agreement. (See Chapter 12.)
- resale price**, in the case of a CLT, the maximum price for which improvements on CLT land may be sold by the ground lessee. See *purchase option price*, above.
- resale restriction**, any restrictions on the resale of a property under the terms of a specific agreement. CLT ground leases normally restrict resale with regard to both the price for which the *improvements* can be sold and the qualifications of those who are permitted to purchase the improvements.
- reserve fund**, a fund established and managed for the purpose of meeting anticipated future expenses. An increasing number of CLT homeownership programs allocate a portion of the ground lease fee to a repair/replacement reserve fund that will help to pay for necessary future replacements and repairs (e.g., replacement of roofs, heating systems, etc.). (See Model Lease, Sections 5.1 & 7.6 and related commentary.)
- restraints on alienation**, restrictions on a property-owner’s right to alienate (transfer title to) a property. Such restrictions are prohibited in certain circumstances under common law and in some states by statutes codifying old English common law of property. (See Chapter 9.)
- rider**, an attachment to a written agreement, signed by the parties to the agreement, modifying the terms of the agreement for some period of time (not necessarily for the full term of the agreement) or only in relationship to an identified third-party, such as for the benefit of a particular lender. See chapter 20 regarding CLT *ground lease riders* that modify the terms of the ground lease to accommodate the concerns of a *mortgagee* during the term of a particular *mortgage*.
- right of first refusal**, the right to purchase a property for a price offered by a third party and accepted by the owner. If an owner grants a right of first refusal and subsequently receives an acceptable offer from a third party, the owner must give *notice* to the holder of the right and give the holder an opportunity to purchase the property for the offered price before the property can be sold to the third party.
- rule against perpetuities**, the common law rule prohibiting the establishment of perpetual so-called “unvested” ownership rights relating to a particular property, such as a perpetual option to purchase a property. (This is a highly technical rule that in most states is not in any conflict with the terms of the Model Ground Lease. See chapter 9.)
- Rural Development**, an agency of the U.S. Department of Agriculture administering various federal programs designed to benefit rural communities and residents of rural areas.
- Rural Housing Services**, an agency administering affordable housing programs within the *Rural Development* agency.
- safe harbor guidelines**, published by the IRS in 1996 (as Revenue Procedure 96-32) describing the circumstances under which an organization can be assured that its housing

projects qualify as charitable on the basis of the specific income levels of the populations housed in these projects – therefore the guidelines on the basis of which many housing organizations qualify for *501(c)(3) status* (See Chapter 6.)

**Section 8**, a federally-funded program that provides rental housing subsidies for low-income households. These subsidies are provided by *HUD* as either “tenant-based assistance” or as “project-based assistance.” In either case they pay the difference between fair market rent and the amount considered affordable for the tenant, determined as a percentage of the household’s income.

**secondary mortgage market**, a market for the purchase and sale of existing mortgages. See *Fannie Mae* and *Freddie Mac*, above.

**separation of title**, the process by which the title to buildings and/or other *improvements* comes to be held by a party other than the owner of a fee interest in the *land*. (See Chapter 10.)

**settlement price**, the price of a home as stated in a “HUD-1 Settlement Statement.”

Distinguished from *base price* as used in this manual, the settlement price is the price paid for a home including any subsidy that is allocated to the homebuyer (rather than to the CLT). (See Chapter 12.)

**severability**, the right of an owner of buildings or other improvements to remove them from the leased premises on which they are situated. A *ground lease* may or may not permit such removal of improvements. Most CLT ground leases do not. (See Model Ground Lease, Section 7.1. See also Chapter 10.)

**shared equity homeownership programs**, a term that has come to be used to describe a range of resale-restricted affordable homeownership programs, including CLTs, deed-restricted programs, and limited equity coops.

**simple appraisal-based formulas**, a type of *appraisal-based formula* that allocates to the seller a specified percentage of the appreciated combined market value of both the improvements and the land. (See Chapter 12.)

**standard permitted mortgage**, as defined in the Model CLT Ground Lease (Section 8.4), a *leasehold mortgage* that meets certain requirements stated in the ground lease (or an exhibit attached to the ground lease), and that the CLT is required to permit.

**sublease**, an arrangement whereby a *lessee* leases all or a portion of the *leased premises* to a third party for some portion of the *lessee’s* remaining term. CLTs normally permit a sublease only with the *lessor’s* approval. (See Model Ground Lease, Section 4.5.)

**subsidy**, gift, grant or deferred loan used to reduce the cost of housing for the occupants. (See Chapter 19.)

**subsidy recapture**, in the case of subsidized homeownership, the practice of requiring the homeowner to repay the *subsidy* when the home is resold.

**subsidy retention**, in the case of subsidized homeownership, the practice of “locking” the subsidy in place so that the home will remain affordable for subsequent homebuyers of modest means.

**sweat equity**, *equity* that is credited to homeowners when they construct or improve their own homes with their own hands.

**tax-exempt status**, status of an organization that has been recognized as exempt from the obligation to pay certain taxes. (See Chapter 6)

- termination**, the act of concluding a *lease* – and thereby extinguishing the rights of the *lessee* under the lease – before the *expiration* of the full term of the lease. A lease may be terminated as a result of a *default* by one party or the other. (See Model Lease, Article 12.)
- title**, ownership rights to *real estate*, or evidence of such ownership.
- title company**, a company that sells *title insurance* based on its examination of land records and its determination that the party conveying ownership of a property has *title* to that property and can legally convey it. Title companies can play a significant role in coordinating real estate transactions (see Chapter 22).
- title insurance**, a policy insuring an owner of real estate or a mortgagee against loss resulting from a defect in the *title* to the real estate conveyed to the policy-holder.
- title theory states**, states in which a mortgage is interpreted as conveying *title* to the mortgaged property to the *mortgagee* until the mortgage debt has been fully paid. Distinguished from *lien theory states* (see above). The instrument used for title theory transactions may be called a *mortgage deed* or *deed of trust*.
- transfer fee**, in the case of a CLT, a fee paid by the buyer of a home (when it is resold by a previous homeowner) which is added to the purchase option price received by the seller. Increasingly common among CLTs, these fees are an important source of long-term support for CLT stewardship functions. (See Chapter 13 and Section 10.12/13 of the Model Lease and related commentary.)
- trust**, a fiduciary arrangement whereby property is conveyed to an individual or institution that, as a “trustee,” manages the property for the benefit of one or more designated beneficiaries. Although a community land trust does hold and manage real estate for the benefit of the local community, it is not organized, legally, as a trust; it is organized as a not-for-profit corporation.
- waiver**, the act of relinquishing – choosing not to exercise – a particular right, claim or privilege.

**H11966**

**CONGRESSIONAL RECORD - HOUSE**

**October 5, 1992**

**SEC. 212. HOUSING EDUCATION AND ORGANIZATIONAL SUPPORT FOR  
COMMUNITY LAND TRUSTS**

(a) *COMMUNITY LAND TRUSTS.* --- Section 233 of the Cranston-Gonzales National Affordable Housing Act (42 U.S.C. 12773) is amended -

(1) *in subsection (a)(2) by inserting "including community land trusts," after "organizations";*<sup>1</sup>

(2) *in subsection (b), by adding at the end the following:*<sup>2</sup>

(6) *COMMUNITY LAND TRUSTS.* --Organizational support, technical assistance, education, training, and community support under this subsection may be available to community land trusts (as such term is defined in subsection (f) and to community groups for the establishment of community land trusts"; and

(3) *by adding at the end of the following:*

(f) **DEFINITION OF COMMUNITY LAND TRUST.**---For purposes of this section, the term "community land trust" means a community housing development organization (except that the requirements under subparagraphs (C) and (D) of section 104(6) shall not apply for purposes of this subsection)--

"(1) that is not sponsored by a for-profit organization;

"(2) that is established to carry out the activities under paragraph (3);

"(3) that--

"(A) acquires parcels of land, held in perpetuity, primarily for conveyance under long-term ground leases;

"(B) transfers ownership of any structural improvements located on such leased parcels to the lessees; and

"(C) retains a preemptive option to purchase any such structural improvement at a price determined by formula that is designed to ensure that the improvement remains affordable to low-and moderate-income families in perpetuity;

"(4) whose corporate membership that is open to any adult resident of a particular geographic area specified in the bylaws of the organization; and

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<sup>1</sup> The subsection of the 1990 legislation that is here amended reads as follows: "(a) In General – The Secretary is authorized to provide education and organizational support and assistance in conjunction with other assistance made available under this subtitle... (2) to promote the ability of community housing development organizations to maintain, rehabilitate and construct housing for low-income and moderate-income families in conformance with the requirements of this title."

<sup>2</sup> Subsection (b) begins as follows: "(b) Eligible Activities – Assistance under this subsection may be used only for the following eligible activities..."

Appendix B: CLT Definition from Housing and Community Development Act of 1992

*"(5) whose board of directors---*

*"(A) includes a majority of members who are elected by the corporate membership;  
and*

*"(B) is composed of equal numbers of (i) lessees pursuant to paragraph (3)(B), (ii) corporate members who are not lessees, and (iii) any other category of persons described in the bylaws of the organization."*

*Note: This sample “Memorandum of Lease” (which may also be called “Notice of Lease” or “Short Form Lease”) is designed to be recorded as required by Section 14.12 of the Model CLT Ground Lease.*

## MEMORANDUM OF GROUND LEASE

Between Mary Doe and Hometown CLT

This Memorandum Of Ground Lease (the “Memorandum”) is made and entered into this \_\_\_\_ day of \_\_\_\_\_, by and between Mary Doe, whose address is \_\_\_\_\_ (the “Homeowner”) and Hometown CLT, with offices at \_\_\_\_\_ (the “CLT”).

### WITNESSETH:

Hometown CLT is the owner of certain real property located in \_\_\_\_\_ County, in the state of \_\_\_\_\_, known as \_\_\_\_\_, (the “Leased Land”), more particularly described as follows:

(legal description)

Mary Doe is the owner of the house and other improvements (the “Home”) located on the Leased Land and purchased the Home subject to the terms of an unrecorded Ground Lease (the “Lease”) between Hometown CLT as the lessor and Mary Doe as the lessee, which Ground Lease is dated \_\_\_\_\_.

The provisions of the Lease include the following.

- The Lease commences on \_\_\_\_\_ and terminates on \_\_\_\_\_. The Lease is subject to a renewal for an additional period of 99 years.
- The Lease prohibits Homeowner from mortgaging the Home and Homeowner’s interest in the Leased Land without the consent of the CLT.
- The Lease requires that, in the event the Homeowner intends to sell the Home, Homeowner shall notify the CLT of such intent; and that, thereupon, the CLT shall have the option to purchase the Home on the terms and conditions contained in the Lease. The Home may not be conveyed to a third party without compliance with the terms of the Lease.
- The Lease stipulates that the Homeowner’s interest in the Leased Land shall not be assigned or subleased without the prior written consent of the CLT.

- The Lease requires that the Leased Land be used only for residential purposes. Any additions or alterations to the Home must comply with the terms of the Lease.
- No liens for services, labor, or materials shall attach to the CLT's title to the Leased Land.
- The Lease requires the Homeowner to make certain monthly payments.
- The Lease requires that this Memorandum of Ground Lease be recorded in the records of \_\_\_\_\_ County, \_\_\_\_\_.

This Memorandum is executed pursuant to the provisions contained in the Lease and is not intended to vary the terms and conditions of the Lease, but is intended only to give notice of such Lease and the provisions thereof.

IN WITNESS WHEREOF, the undersigned have executed this Memorandum of Ground Lease.

HOMEOWNER:

CLT:

(notarize signatures)

*Note: this sample represents one of a number of possible ways in which a CLT can formally assign its purchase option to a prospective buyer. The conditions stated in the assignment document (here "a," "b," "c," and "d") will vary depending on what conditions have already been met or are otherwise covered. As noted in Chapter 22, "CLT Real Estate Transactions," when the CLT is a party to a three-way contract along with the seller and buyer of the Improvements, the assignment of the purchase option to the buyer may be handled as part of that contract and no separate assignment document may be necessary. If the purchase option is not formally assigned until the closing of the transaction, the assignment document can be a very simple one, since all conditions would be conditions of the closing itself and would not need to be separately stated.*

### ASSIGNMENT OF PURCHASE OPTION

**Hometown Community Land Trust** ("the CLT") of 00 Main Street, Hometown, \_\_, 00000,

as present holder of an option to purchase the improvements (the "Home") located at \_\_\_\_\_ from Mary Doe, present owner of the Home, which option to purchase (the "Purchase Option") is stated in Article 10 of a ground lease executed on the \_\_th day of \_\_\_\_\_, 20\_\_, by Hometown Community Land Trust and Mary Doe (the "Ground Lease"),

**hereby assigns the Purchase Option to**

\_\_\_\_\_ ("Assignee") to be exercised by Assignee on the terms and conditions stated in the Ground Lease provided that Assignee:

- a) shall satisfactorily demonstrate that s/he is an Income-Qualified Person (as defined in the Ground Lease) at the time when s/he will complete the purchase of the Improvements;
- b) shall pay to the CLT an assignment fee [or "transaction fee"] of \$\_\_\_\_\_, and shall make or provide for all other payments necessary to complete the purchase of the Improvements
- c) shall present signed Letters of Acceptance [or "Stipulation] and Attorney's Acknowledgement similar to those attached to the Ground Lease;
- d) shall, simultaneously with the purchase of the Improvements, accept an assignment of the Ground Lease\* or enter into a new ground lease with the CLT substantially the same as the Ground Lease.

By: \_\_\_\_\_

(authorized CLT representative)

(date)

For: Hometown Community Land Trust

*\*Note: If the ground lease is based on the 2011 NCLTN Model Lease, the phrase “accept an assignment of the Ground Lease” should be omitted, since the 2011 version of the model requires that a new lease be issued.*