

Introduction to the Ground Lease

The legal instrument that defines the arrangement between CLT and homeowner

What is the purpose of the ground lease?

- Describes relationship between homeowner and the community land trust
- Provides durable controls on resale -- allocating equity at resale is a balancing act
- Enables community to balance interests
- Distributes the “bundle of rights” – which ones to pass to homeowner and which ones to reserve to CLT in order to preserve social goals?
 - ✓ Protects homeowner’s rights and interests – occupancy, peaceful enjoyment, control over alterations, earning fair return on investment, right to convey/sell
 - ✓ Protects CLT’s interests in preserving affordability and protecting subsidy invested
 - ✓ Protects lender’s interests in case of foreclosure (ground lease rider)

Lease decision points: a continuum of choice (see handout: “CLT Ground Lease Major Decision Points”)

- ✓ Attorney consultation for buyer
- ✓ Occupancy: what is “most of the time”?
- ✓ Use: does the CLT have the right to inspect? what about expectations concerning the condition of the building?
- ✓ Sublease: should it be allowed? how much rent allowed?
- ✓ Lease fee: how much to charge as consideration for use of land?
- ✓ Alterations/maintenance: How hands-on does the CLT want to be?
- ✓ Resale formula: does it lean toward preserving affordability or enabling mobility?
- ✓ What is the CLT’s role in managing the resale – does it step into chain of title? does it assign its right to purchase to the next buyer? does it put responsibility for sale/negotiations on the buyer and seller to work out?
- ✓ Heirs: who is eligible? income-qualified

Lease as **Transfer of Property Rights** to Homeowner

- Right to **occupy**
- Right to **secure financing**
- Right to **sub-lease** portions of property
- Right to **make alterations** and improvements
- Right to **convey** property to heirs
- Right to **re-sell** property

Lease as **Definition of Requirements & Expectations**

- Restrictions on **use**: residential only; good neighbor clause
- Restrictions on **occupancy**: owner-occupied “most of the time”
- Restrictions on **transfer**: “heirs” need not income-qualify; others must income-qualify; limit on resale price; maintain home in good, safe condition

Recitals: contain the goals and purposes of the lease:

- to provide *opportunity for homeownership* that would not otherwise exist
- to *preserve availability and affordability* of this opportunity for others in the future

Letter of Agreement & Letter of Acknowledgment

- Protection for homebuyer and for CLT
- *Letter of Agreement*: Homebuyer states, or stipulates, that buyer understand the rights, responsibilities, and restrictions defined in the lease agreement – “the CLT deal”
- *Letter of Acknowledgment*: Attorney has reviewed the lease and related documents with buyer and that homebuyer understands and agrees to its terms

Lease as Transfer of Property Rights to Homeowner

Right to Occupy:

Article 2. Demise of Leased Premises

- CLT *leases the land* to the homeowner to use
- CLT *keeps the mineral rights*

Article 3. Duration of Lease

- *Ninety-nine years*
- *Renewable*: Homeowner/leaseholder may add another 99 years to the lease at end of initial 99-year lease term
- *Binding*: Any new land owner is bound by the lease, can’t change terms without homeowner’s agreement
- *Right of first refusal* for homeowner

Right to Sublease Portions of the Property

Article 4. Assignment and Sublease

- Homeowner may *not* rent home without *prior written consent* of the CLT
- Prevents absentee ownership and windfall profit from rental activity
- If allowed, CLT must also approve the amount of rent charged
- Renter must comply with lease use restrictions

Right to Secure Financing:

Article 8. Financing

Three-way relationship: certain rights given to homeowner, lender and CLT

1. Right of homeowner to obtain a loan if it meets certain conditions that protect homeowner’s and CLT’s interests.

- *Standard loan* from “institutional lender” in *first lien* position
- Lender *notifies* CLT if homeowner default
- CLT right to *cure default*

2. Rights of lender

- *Cure default* of lease or take over lease if lender forecloses the loan
- 30 days to *approve or disapprove any changes to lease*
- If the lease is terminated for any reason, the CLT must sign a lease with the lender
- *Removal of certain provisions pursuant to foreclosure*

3. Rights of CLT:

- Right to *purchase pursuant to foreclosure*

- Right to *proceeds in excess of purchase option price* – homeowner cannot receive more from sale of home than “Purchase Option Price.” Also true if lender takes title to the home

Right to Make Alterations

Article 7. Improvements

- Homeowner owns all of the buildings and other improvements on the land, & any later added
- Improvements stay with the land
- Homeowner may make alterations *only* with prior written approval by CLT – and:
 - Homeowner pays all costs
 - “Workerlike” manner, in compliance with codes & ordinances
 - Consistent with uses permitted by the lease
 - CLT gives written consent for major improvements
 - CLT gets a copy of building permits before work begins
- *No liens* due to unpaid work
- Homeowner must *maintain land & improvements* in good condition

Right to Convey Property to Heirs

Article 10. Transfer, Sale or Disposition of Improvements

- Homeowner may will the improvements to heirs (children, spouse, others as defined by lease)
- Many CLTs allow “designated heirs” to not be income-qualified (while any other heir(s) must be income-qualified)
- Allowed heirs assume ownership of improvements and remaining term of ground lease

Right to Resell Improvements

Article 10. Transfer, Sale or Disposition of Improvements

- Homeowner may resell house
- Homeowner typically has ability to receive equity at resale
- Sales price is restricted so that home remains affordable to next limited-income homebuyer

Lease as Definition of Requirements & Expectations

Restrictions on Use

Article 4. Use of Leased Premises

- *Residential use only*: in compliance with local laws
- *Responsible use, compliance with law*: homeowner must be a good neighbor, use the land without creating public or private nuisances
- *Responsible for others* who use the land, including family, friends, and visitors

Restrictions on Occupancy

Article 4. Use of Leased Premises

- Owner-occupied “*most of the time*”
- The CLT has the *right to inspect the land* and the outside of the home, but cannot inspect the inside of the home

- Land lessees have the right to *peaceful enjoyment* -- undisturbed use of the land. The CLT doesn't care about – and won't interfere with – personal beliefs, visitors, or personal life, unless they violate the lease

Responsibilities with Use

Article 5: Ground lease fee

- Homeowner pays *nominal monthly fee* as consideration for use of land
- Many CLTs also require homeowners to pay monthly Repair & Replacement Reserve fee
- Fees may be suspended or waived by CLT in event of hardship for homeowner
- Fees may be increased over time; typically, upon set anniversaries or increases capped

Article 6: Taxes

- *Homeowner pays property taxes* on house and land
- Taxes may be reduced by the local taxing jurisdiction

Article 9: Liability, Insurance, Damage and Destruction, Eminent Domain

- *Homeowner is liable* for whatever happens on the land
- Homeowner must keep adequate *hazard and liability insurance* that names CLT as an additional insured
- *Damage or destruction*: insurance proceeds must be used to rebuild house unless impossible or too expensive
- Provisions in lease protect homeowner's interests in event of *eminent domain taking for public dedication*

Restrictions on Transfer

Article 10. Transfer, Sale, or Disposition of Improvements

Governs how the house may be conveyed

Income Restrictions

- Home may only be sold or transferred to *Income-Qualified Buyer* (except to “designated heirs”)

Resale Price Restrictions

- *Resale formula* designed to keep home affordable
- *CLT has right to purchase home* at formula-driven price (CLT *may assign its right* to Income Qualified Buyer)

Process Restrictions

- Homeowner must *notify the CLT in writing*
- *CLT may get an appraisal* to determine fair market value of home and land
- Lease provides *timeframes* for exercise of options
- If CLT does not buy home and homeowner has moved out, CLT has *power of attorney* to seek a buyer and negotiate sale at a reasonable price – prevents home from long-term vacancy

Allocating Equity at Resale – Using a Resale Formula to Balance: Fair and Equitable Return to Seller and Fair and Affordable Price to Buyer

What are the goals in designing resale formulas?

Primary and secondary goals:

- Fair allocation of equity
- Fair and reasonable return on investment
- Preserves affordability
- Enables mobility
- Easy to understand
- Easy to administer

Major approaches used by CLTs to determine “fair” resale formulas

- ❑ **Indexed:** Original price x change in index = resale price
 - ✓ For every year that the homeowner owns her home, its value changes by the percent change in the index factor
 - ✓ Some CLTs peg the index to an annually adjusted index (e.g., annual change in Area Median Income). Other CLTs set annual percentage (e.g., 2% per year)
 - ✓ This calculation is done annually and the base price adjusted
 - ✓ These formulas do not rely on appraisals

Questions: What is the “right” index do? Does that index fairly reflect what’s happening in local market?

- ❑ **Appraisal-based:** Resale Price = Original Purchase Price + a share of the gain in the value of improvements (or leased land and improvements)
 - ✓ Gain in value is determined by independent appraisals at initial sale and at resale
 - ✓ Seller receives a designated percentage of any gain in value at resale plus all of the equity built through paying down of mortgage debt
 - ✓ Some formulas give seller a share of appreciation on improvements only
 - ✓ Some give seller a share of appreciation on entire property (land + improvements)
 - ✓ Some CLTs increase the percentage share over time to reward longevity

Questions: How to predict changes in market values over time? Will the house remain affordable over time to same target demographic? What “share of appreciation” is most fair in balancing wealth-building with affordability?

When Things Don’t Go Right

Article 12. Default

- Default on the lease = breaking any of its provisions
- *Monetary or non-monetary*
- *Timeframes* for good-faith efforts to cure
- If homeowner is bankrupt or insolvent and is forced by a judicial process to give the home to creditors, CLT can terminate lease

- If homeowner fails to fix default, CLT can terminate lease and evict from the land
- If CLT is in default, homeowner must notify CLT in writing; CLT has 60 days to fix the problem

Article 13. Arbitration or Mediation

- Used to *resolve disputes* if CLT and homeowner can't resolve differences on their own
- *Binding* decision
- *Costs split equally* between homeowner and CLT

Fannie Mae Ground Lease Rider

- Addresses events of default leading to *foreclosure*
- *Releases restrictions* on occupancy, resale price & income of next buyer

Miscellaneous Provisions

Other General Provisions in Lease

- For CLTs that are membership organizations, every homeowner is automatically a voting member of the CLT
- CLT can waive requirements of the lease, in writing
- The Ground Lease is the *only* agreement about leasing the land and can be changed *only* in writing by both homeowner and CLT

Exhibits

Attached to the lease and part of the lease

- *Letter of Agreement*. From homebuyer – understands the CLT deal
- *Letter of Acknowledgement*. From attorney – has reviewed lease with homebuyer
- *Legal description* of the leased land
- Description of any *restrictions on use of land* that aren't written into the lease itself
- Appraisal
- Other documents, as appropriate