

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).¹ 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.

¹ Mass. Gen. Laws, Ch. 59, Sec. 59.