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.[1]

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.[2] 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 remaions 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.[3] 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 issues 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.[4] 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).[5] 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 on 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 thought 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.[6]

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.

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.[7] 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 thought 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.[8] 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]."[9] 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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[1] 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

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.

[2] 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.

[3] 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).

[4] States will vary in the mount 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.

[5] 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…"

[6] 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.

[7] FHA ground lease fee regulations are found in HUD Handbook 4150.1 REV-1, pp. 6-24--6-25.

[8] 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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[9] 24CFR Section 203.41(d).