Chapter 8
Implementing Restrictions on Ownership

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

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

Types of Restrictions

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

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

Price restrictions. Resale price restrictions limit the price for which a property can be sold, with the intention of keeping the price affordable for households of a designated income level. Affordability is normally measured in terms of the amount of mortgage payment that a household with a given income can afford, in addition to taxes and insurance (and lease fee in the case of CLT homeowners), assuming that a high percentage of the purchase price is mortgage-financed (usually at least 95%)). The price restrictions usually allow the homeowner, when she sells, to recoup her original investment plus a limited amount of appreciation determined by one or another type of "resale formula." (See Chapter 12, "Resale Formula Design," for a full discussion of the various types of formulas.) When an owner wants to sell, the restrictions are enforceable through a "preemptive option" that allows the CLT or other sponsoring agency to purchase the property for the lesser of the formula-based price or the property's appraised value. (It is important to distinguish clearly between such *price restrictions*, which result in "below-market" prices, and *subsidy-recapture* requirements, which allow a property to be sold for a full market price, out of which the subsidy is then to be repaid.

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

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

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

Methods of Establishing and Enforcing Ownership Restrictions

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

Deed Restrictions. Deed restrictions (also known as deed covenants) are attached to the deed of a property and are written in terms that will bind subsequent as well as present owners of the property. The specific provisions can vary from very simple restrictions to very elaborate sets of restrictions and requirements. Deed restrictions have been common with homes in subdivisions where developers have wanted to prevent buyers from modifying such things as the color, size or shape of their houses in ways that might offend the conventional expectations of their neighbors, and they have come to have an important role in the various forms of "common interest ownership," such as condominiums.

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

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

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

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

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

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

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

Chapter14, "CLTs and Condominiums"). Such ground leases can also be used by any other public or private entity wishing to restrict the transfer or use of housing. Some public housing authorities (e.g., in Boulder, Colorado) have used ground leases to restrict use and resale of subsidized resident-owned units. At least one municipality (Minneapolis) has used ground leases to assure the preservation of resale restrictions for subsidized limited-equity coops. And some Universities (e.g., Stanford University) have used ground leases to preserve the affordability of resident-owned homes for faculty members.

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

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

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

Conservation easements. Conservation or agricultural easements (sometimes known by other terms, including "agricultural restrictions" and "servitudes") have become a common means of establishing restrictions on the ownership of agricultural property. The type of conservation easement widely used by conservation land trusts removes some or all development rights from a parcel of land and may establish other restrictions designed to preserve ecologically sound use. Such easements are frequently used to preserve farmland, as well as other forms of open space. When the goal is to preserve farmland or whole farms *as farms that farmers can afford to buy*, the easement may give the holder a preemptive option to purchase the property for its appraised *agricultural value*, as is the case with farm preservation programs in Massachusetts and Vermont. The provisions of some such easements can be very similar to CLT lease provisions – with restrictions relating to price, buyer eligibility, owner-occupancy, and use.

Comparison of Deed Restrictions and Leases

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

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

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

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

The legal status of long-term deed restrictions varies from state to state. Some states specifically limit deed restrictions to a certain period (e.g., 30 years), and in most states "perpetual" deed restrictions are considered invalid as a "restraint on alienation" or violation of the "rule against perpetuities" (see Chapter 9, "Enforceability of the CLT's Preemptive Right," regarding these common law principals). Generally, the longer the duration of the restriction and the farther the party imposing the restriction is removed from the property, the less defensible is the restriction. A few states (currently Massachusetts, Vermont, Maine, Rhode Island, and Oregon) have enacted laws explicitly authorizing "perpetual" deed restrictions for the purpose of preserving the affordability of subsidized owner-occupied housing. Most states, however, have not.

Even if all the legal obstacles to enforcement of these affordable homeownership covenants are removed, the restrictions are often not effectively enforced. The supposed self-enforcement process may not work in practice – at least not for the full set of restrictions. It is worth looking at what is likely to happen with regard to the enforcement of each of the four types of restriction noted above when a deed-restricted property is to be sold in the absence of a fully developed monitoring program.

- *Price restrictions.* The assumption has been that, when a property is to be sold, a diligent title search – conducted for a potential mortgagee or title company – should bring the price restriction to light, and a potential buyer or mortgagee would not knowingly choose to violate them. If the difference between the allowable "purchase option price" and the then market price is great, however, the owner of the property may have a strong incentive to avoid price restrictions. A speculator, especially if prepared to pay cash, may be willing to pay more than the purchase option price if the actual price would still be enough below the property's market value so that the risk of a legal challenge would be seen as worthwhile. Or the necessary title work may simply not be done carefully enough at the time of resale, with the result that the existence of a restriction attached to a deed decades earlier may *not* come to light. (For this reason, some CLTs record not only the covenant but a lien securing a loan for a nominal amount as a more familiar way of flagging the existence of the restrictions.)
- *Buyer eligibility restrictions*. Buyer eligibility restrictions relating to the incomes of potential buyers are probably more likely to be violated in practice than are price restrictions. The price for which a property is to be transferred is necessarily known by the parties to a transaction, whereas the buyer's income is not necessarily known unless the transaction is monitored by an agency that will insist on reliable documentation of the buyer's income.
- *Occupancy and use restrictions*. These restrictions, which must be applied on an ongoing basis, not just at the time of transfer, are obviously not self-enforcing. Without ongoing monitoring, there is little to prevent an owner from moving out of a restricted home and renting it for a substantial profit, and/or allowing its condition to deteriorate to the point where the public's investment in the property is wasted.
- *Mortgage financing restrictions*. Practical enforcement of these restrictions requires that a monitoring agency be in position to review proposed mortgage terms and determine whether they are consistent with the restrictions.

Until quite recently, because they were assumed to be self-enforcing, deed restrictions generally were not monitored. Programs were simply not being funded or put in place to support monitoring. As the failure of self-enforcement has become more apparent, however, a growing number of programs *are* now being established to monitor and enforce deed restrictions established through state and municipal programs that subsidize affordable homeownership or that require its creation through "inclusionary" ordinances (see John E. Davis, *Shared Equity Homeownership: The Changing Landscape of Resale-Restricted, Owner-Occupied Housing*, published by the National Housing Institute). In fact a growing number of CLTs are now charged with responsibility for monitoring deed-restricted homes.

Finally, it should be noted that a sponsoring agency that does not have a continuing relationship with the homeowner is not only less able to enforce restrictions; it is also not in position to provide support services for lower income, first-time homeowners. If a homeowner gets into financial trouble, such an agency will not be aware of it and will not provide assistance. If the financial trouble results in a mortgage foreclosure, a deed restriction that has been subordinated to the mortgage (as is usually the case) will be wiped out. Not only will the homeowner lose her home, but the public will lose the investment it has made in the affordability of the home.

CLT leases. Compared to deed-restricted homeownership, the CLT's seemingly more complicated approach to homeownership restrictions involves features that are less familiar to the majority of homebuyers and home mortgage lenders. However, the CLT lease does have some important advantages, both as a means of establishing and enforcing restrictions on ownership and as a basis for supporting lower income homebuyers. These advantages include the following.

- The fact that the lease represents an agreement between parties that both have continuing ownership interests in the property provides a strong legal basis for the long-term – in fact perpetual – enforcement of restrictions.
- Through its collection of a monthly lease fee, the CLT is positioned to monitor the homeowner's occupancy and use of the property. (A CLT may of course be similarly positioned to monitor covenant-based restrictions through the collection of a monthly "stewardship fee".)
- Through its collection of a monthly lease fee, the CLT is positioned to recognize financial (or other) problems experienced by a homeowner, and to assist in dealing with these problems. (Again, the collection of a monthly "stewardship fee" may help to create a similar relationship.)
- As ground lessor, the CLT is positioned to review proposed mortgage financing and prevent financing that would expose the homeowner to undue risk.
- In the event of foreclosure of a leasehold mortgage, the CLT may be able to re-acquire the foreclosed home, and in any case will retain the community's investment in the land.

Although theoretical questions have been raised as to whether the 99-year term of the CLT's preemptive option might be held to violate the rule against perpetuities (potentially exceeding the traditional common law measure of a "life in being plus 21 years"), to our knowledge the CLT preemptive purchase option has never been challenged in court and there are reasons to believe that such a challenge would not succeed (see Chapter 9, "Enforceability of the CLT's Preemptive Right").

The CLT lease also provides a strong legal basis for enforcing the CLT's occupancy and use restrictions. The exact procedural details and substantive requirements will differ from jurisdiction to jurisdiction. Generally, however, the lessee's rights of possession of the land depend upon compliance with the lease terms. Failure to comply with these terms gives rise to the right of the landlord to terminate the lease and evict the lessee or seek other remedies, such as damages or injunctive relief, where appropriate.

On the *practical* level, the CLT lease provides an effective means of seeing that all four types of restriction are actually enforced.

- *Price restrictions.* When the homeowner eventually wants to sell, the possibility that the sale could be carried out in violation of the lease's price restrictions is extremely limited. Any but the most woefully ill-informed and ill-advised buyers would understand that they could not buy the land from the existing homeowner and would *have* to deal with the CLT land owner. The CLT will be a party to the transaction. Before approving the transfer of the lease or entering into a new lease with the buyer the CLT will make sure that the price is permitted under the restrictions.
- *Buyer eligibility restrictions.* Again, the CLT will be a party to the transaction. Before the transaction can be closed, the seller will need to be sure that documentation of the buyer's income qualifications has been submitted to the CLT for its approval.
- *Occupancy and use restrictions*. The likelihood that the these restrictions will be enforced in practice is supported by the necessary ongoing interaction between the parties. In particular, the homeowner is responsible for making monthly lease fee payments to the CLT (unless these are paid to and escrowed by a mortgagee). If a CLT finds that these fees are not being paid, it will typically contact the homeowner and may then learn of other problems or violations; for instance, the homeowner may no longer occupy the home and may have rented it to others. (Again, a number of CLTs now do charge monthly "stewardship fees" to the owners of deed-restricted condominium units.)
- *Mortgage financing restrictions*. A typically diligent lender will recognize the fact that the lessee does not own the fee interest in the land. Before accepting the leasehold interest as collateral, the lender will review the lease document that creates that interest, and will learn that the mortgage must be explicitly permitted by the CLT land-owner. (In the few instances where a not-so-diligent lender has taken a mortgage without the knowledge and permission of the CLT and where foreclosure is then threatened, it has been possible for the CLT to prevent foreclosure by showing that its rights as lessor have been circumvented.) Before permitting a mortgage, a CLT normally seeks assurance that it will have the right and opportunity to cure such a default, that it will have a right to purchase a defaulted mortgage, and, in some cases, that it will have an opportunity to repurchase a foreclosed home – all of which reduce the likelihood that the public's investment in an affordable home will be lost.

In summary, the CLT's ability to ensure that all of these restrictions are enforced in practice is strongly supported by the closeness of the relationship between the CLT and the lessee as co-owners of the property. In this respect, the CLT ground lease has a fundamental advantage over *un-monitored* deed restrictions. In situations where deed restrictions *are* monitored – by a CLT or other agency – the difference between deed restriction and ground lease is of course reduced – with the degree to which it is reduced depending on the closeness of the relationship. If deed restrictions on a home are monitored by an organization to which the homeowner is obliged to pay a monthly fee (regardless of what the fee is called) and if the state is one in which there is a statutory provision for perpetual affordability restrictions, then the difference in enforceability is likely to be slight. And the difference may be even further reduced if the homeowner is also related to the monitoring organization as a *member* of that organization.

Even when there is little difference in the enforceability of the two kinds of restrictions, however, the CLT lease still has one potentially important advantage over the deed restriction. A mortgage on a deed-restricted home applies to the entire property (land and improvements). If the mortgage is foreclosed – or a deed in lieu of foreclosure is given – the entire property, and the public's investment in that property, will be lost (unless the mortgage has been subordinated to the restrictions, which is rare). A mortgage on a CLT home, however, normally applies only to the improvements and the leasehold interest in the land. If the leasehold mortgage is foreclosed, the CLT will retain ownership of the fee interest in the public's property, the land. Whoever then acquires ownership of the improvements will become a lessee of the CLT. In such situations the Model Lease allows the removal of resale and occupancy restrictions, but, if this happens, the lease then allows the CLT to increase the lease fee to reflect the market value of the no-longer-restricted property, so the CLT will receive an ongoing revenue stream, which may be substantial in some markets, and which can be used to help support the CLT's program until such time as the organization either reacquires the improvements on affordable terms or liquidates its equity in the land entirely.

Finally, It should be said that, in the eyes of some, the CLT ground lease is preferable to the deed covenant on philosophical grounds. The ground lease treats land and improvements as two fundamentally different forms of property – land as a limited resource in which all members of a community have a necessary interest, improvements as human creations in which particular individuals have a more exclusive interest. Deed covenants do not make this philosophical distinction. They may establish the same restrictions as CLT leases, but in the eyes of many CLT advocates, the restrictions are not philosophically grounded in the way that CLT lease restrictions are.