



# Community Land Trusts: A Primer for Financial Institutions

*A Community Land Trust (CLT) is a private, nonprofit corporation created to provide secure affordable access to land and housing for the benefit of the community. The CLT provides access to homeownership for people who might otherwise be priced out of the housing market and helps stabilize communities facing gentrification or high foreclosure rates. CLT transactions, like any other residential sale or mortgage refinance, will almost certainly require title insurance. As ground leases are relatively unusual in residential transactions, it is important for title insurers to understand certain key peculiarities. The following primer, while not a legally binding document, summarizes the key issues for both owner's and lender's policies of title insurance.*

## **I. Is the Ground Lease "Financeable"?**

In a CLT transaction, like other types of ground lease transactions, the terms of the lease can vary tremendously based on a variety of factors. In general, however, there are a handful of very specific issues that are typically important to lenders in determining whether the ground lease is financeable. While a wise lender in a CLT transaction will review all of the terms of the ground lease carefully, it will want to focus on the following key issues.

### **A. Ground Lease Term**

A lender will typically want to be sure that the term of the ground lease extends safely beyond the loan's scheduled maturity date. This is because, upon expiration of the ground lease term, the tenant will lose its right of possession, full ownership rights will be returned to the ground landlord, and the loan will become effectively unsecured. In the model ground lease included with these materials, the initial term is 89 years and includes a renewal option for an additional 89 years. This is significantly longer than the typical thirty-year residential mortgage term. Regardless, however, as the term progresses, a lender will need to be mindful of the remaining term of the applicable ground lease in relation to the proposed mortgage loan term.

Some ground leases may grant the lender the right to exercise renewal options on the owner's behalf. The inclusion of such language may allow the lender to count the renewal term in the overall term, thus avoiding the foregoing issue. If not specifically provided for in the terms of the ground lease, a lender should require such a right in a separate agreement with the ground lessor or through a modification of the ground lease.



# Community Land Trusts: A Primer for Financial Institutions

## **B. Ground Rent**

In addition to scheduled monthly mortgage loan payments, a CLT homeowner will be required to pay ground rent and any other amounts payable under the ground lease. While ground rents in CLT transactions are typically below market, they nonetheless constitute an additional monthly cost payable by the homeowner. The lender will need to consider all of these payment obligations in underwriting its loan and confirming the borrower's ability to make loan payments. This includes any ground rent increases that may occur during the term of the ground lease (for example, ground rents may rise over time to keep pace with inflation).

## **C. Permitted Mortgages**

The ground lease should include language that specifically permits the homeowner to mortgage its interest in the property. Such language may specifically define what constitutes a permitted mortgage and whether such a mortgage can be given with or without the approval of the ground landlord. For example, the ground lease might permit a first priority mortgage while barring further subordinate mortgages. It might also limit the types of financial institutions that qualify as permitted mortgagees. If language permitting the requested mortgage is not included in the ground lease, the lender is advised to seek written consent from the landlord before proceeding.

The ground lease may also permit the ground lessor to encumber its fee interest in the land by mortgage. To govern the respective rights of the two lenders, the leasehold lender may wish to consider entering into an agreement with any current fee mortgage holder or obtaining the ability to enter into an agreement with any future fee mortgage holder.

## **D. Notice and Cure Rights; Termination; Foreclosure**

Lenders should be cognizant that an uncured default by the ground tenant could result in termination of the ground lease itself. As a result, a well-drafted ground lease should grant a permitted lender the right to receive notice of any default by the ground tenant from the ground landlord. Thereafter, the lender should have specific rights to cure the ground tenant's default in order to protect itself against the ultimate termination of the ground lease. The ground lease should be reviewed to understand the scope and duration of cure rights, and to confirm that, while there is a right to cure, there is no obligation. Section 8.3 of the model ground lease includes example notice and cure provisions.

Similarly, the ground lease should require that any permitted mortgage include language granting the CLT landlord both (a) the right to receive notice and cure any homeowner mortgage loan default and (b) the right to repay the loan in advance of a foreclosure or assignment-in-lieu of



# Community Land Trusts: A Primer for Financial Institutions

foreclosure in exchange for an assignment of the mortgage loan. Lenders should review the scope and duration of these rights as well. In this context, notice and cure rights may be seen as a credit enhancement in the sense there is another party that may be willing to cure a mortgage default.

A lender should also consider what happens if the ground lease is terminated or if the homeowner files for bankruptcy and rejects its ground lease. In such a situation, the lender should have the right to enter a new ground lease with the CLT on substantially the same terms as previously existed between the homeowner and the CLT.

Finally, a lender should understand that a ground lease mortgage can be foreclosed in Michigan in the same fashion as a typical mortgage of a fee interest. Foreclosure-by-advertisement and judicial foreclosure options are available remedies depending upon the specifics of any given default situation.

## **E. Assignment and Subletting**

Ground leases often include detailed provisions governing the ground tenant's ability to assign and sublet its ground lease interest. These provisions are generally crafted as an outright bar to assignment and subletting that is subject to specific exceptions or conditions under which the CLT will grant consent. From a lender's perspective, it is important that this language clearly allow the ground lease to be assigned in connection with a foreclosure or assignment-in-lieu of foreclosure without the CLT's consent.

## **F. Casualty and Condemnation**

The ground lease should include detailed provisions addressing the full or partial loss of the property as a result of casualty and condemnation. Generally, insurance proceeds should be available to rebuild and restore the damaged home after a casualty. If, however, insurance proceeds are not allocated for this purpose, they should instead be used to repay the mortgage loan.

In the case of condemnation of all or substantially all of the property, the ground lease should terminate and the award should be used to repay the loan. In the case of a smaller, partial condemnation, the ground lease should include detailed language allocating the award in a manner that is reasonable in light of the amount of land condemned.

Another approach (which is taken by Fannie Mae) is to require that if the casualty or condemnation results in lease termination, then the proceeds or award must be used to repay the loan. But if the ground lease is not so terminated, then the proceeds should be used to restore the property in accordance with applicable mortgage provisions.



# Community Land Trusts: A Primer for Financial Institutions

## G. Ground Lease Amendment

The ground lease should include language that makes any amendment entered into without the lender's consent non-binding. The lender may permit so-called "deemed approval" language whereby its own failure to respond to a request to approve an amendment within a stated period of time will result in automatic approval. Such language benefits the borrower and its ground landlord, as it avoids significant delays that can be caused by drawn out lender approval processes. Not all lenders will approve such a clause, and the effects of including or not including a deemed approval clause should be considered by the individual lender.

## H. Estoppel Certificates

Finally, a well-drafted ground lease should grant a mutual right to the parties to receive estoppel certificates. This gives some measure of assurance that the ground lease has not been amended (or gives a list of amendments), that rent has been paid current, and that there are no defaults. A lender should require that its borrower obtain such an estoppel certificate in advance of closing that includes language specifically allowing the lender to rely on the estoppel certificate.

## II. Lender Considerations Beyond the Ground Lease

### A. Title Insurance

A lender's ALTA 2016 loan policy of title insurance should include ALTA endorsement 13.1-06, which addresses valuation of the insured estate for purposes of computing loss or damage in the event of a policy claim. For more information, please see the separate CLT Primer for Title Insurers.

### B. Appraisal

A lender should confirm that its appraiser is fully advised of the nature of the estate being appraised, as it is different (and will likely have a lower value) than a full fee estate in the land and improvements. This will ensure that the appraisal does not overstate the value of the property, and thereby result in a loan size that is larger than it should be.

### C. Secondary Mortgage Market

A lender may wish to sell the CLT ground lease mortgage loan on the secondary market, as opposed to holding the loan on its own books. As these loans are becoming more common, there



# Community Land Trusts: A Primer for Financial Institutions

has been increased understanding and acceptance of their peculiarities in the secondary markets. For example, Fannie Mae offers a CLT program (see [www.fanniemae.com](http://www.fanniemae.com) for details). Notably, Fannie Mae produces a form Community Land Trust Ground Lease Rider designed to ensure the applicable ground lease meets Fannie Mae's requirements.

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