

XI, 312: Leaseholds Held by Community Land Trusts (03/22/06)

Community land trusts are typically nonprofit organizations that acquire land for a variety of reasons—such as to facilitate homeownership among lower-income individuals and families or to maintain a permanently affordable housing stock in a given community. To reduce development costs to an affordable level, a community land trust uses grants, gifts, and subsidy dollars to acquire land (and then retains ownership of that land). The sales price for the improvements situated on the land does not include the subsidy amount used to acquire the land, which means that a borrower will pay a lower purchase price for his or her home (often less than the leasehold interest in the property). The trust offers the borrower a long-term, renewable ground lease. Because of the affordable terms that it offers, a community land trust usually includes in its ground lease restrictions on borrower eligibility, as well as on the resale of the property improvements.

In selecting an appraiser to provide an opinion of value for a leasehold held by a community land trust, the lender must make sure that the appraiser is knowledgeable and experienced in the appraisal techniques—direct capitalization and market derivation of capitalization rates—that are necessary to appraise this type of property.

When a leasehold interest is held by a community land trust, the appraiser must analyze the property subject to the ground lease. Since the community land trust typically subsidizes the sales price to the borrower, that price may be significantly less than the market value of the leasehold interest in the property. The resale restrictions (as well as other restrictions) that may be included in the ground lease also can affect the value of the property. However, we have developed a ground lease rider that the lender and the borrower must execute to remove such restrictions from the community land trust's ground lease (see [*Part VII, Section 102.11*](#)). The land records for the subject property must include adoption of the terms and conditions that are incorporated in this ground lease rider. In view of these concerns, it is important that the appraised value of the leasehold interest in the property be well supported and correctly developed.

The appraiser must use a three-step process to develop his or her opinion of value: (1) determine the fee simple value of the property by using the sales comparison analysis approach to value, (2) determine the applicable capitalization rate (and convert the income from the ground lease into a leased fee value by using the market-derived capitalization rate), and (3) determine the leasehold value by reducing the fee simple value by the leased fee value. When this appraisal technique is used, there is no need to document the actual land value of the security property. The appraiser must develop the opinion of value for the leasehold interest under the hypothetical condition that “the property rights being appraised are the leasehold interest without the resale and other

restrictions that our ground lease rider removes when we have to dispose of a property acquired through foreclosure.” The lender should advise the appraiser that he or she must include the following statement in the appraisal report:

This appraisal is made on the basis of a hypothetical condition that the property rights being appraised are the leasehold interest without resale and other restrictions that are removed by the Uniform Community Land Trust Ground