

SUMMARY:

HUD Regulations Affecting Community Land Trusts

On all but a few points, community land trusts are affected by regulations governing HUD programs in exactly the same ways that other organizations utilizing these programs are affected. This memo is concerned only with those points where CLTs are – or may be – affected differently. Portions of this memo have been adapted from ICE’s *Community Land Trust’s Legal Manual*

HOME Program

For CLTs nationally, the federal “HOME Investment Partnership Program” is the single most important source of both project subsidies and operating support. The Program’s regulations make certain special provisions for CLTs and present no special obstacles to the use of HOME funds by CLTs.

“CHDO status.” Established by the Cranston-Gonzales National Affordable Housing Act in 1990, the HOME Program provides block grants to states and qualifying municipalities to support affordable housing efforts. Each block grant recipient or “Participating Jurisdiction” (“PJ”) must reserve at least 15% of its HOME block grant for investment in housing that is to be “developed, sponsored or owned” by nonprofit organizations that the PJ has certified as “community housing development organizations” (“CHDOs”) In addition, the PJ may use up to 5% of its grant to provide operating support to CHDOs. For these reasons, it is very much in the interest of a CLT to be “certified” by its PJ as a CHDO.

Based upon the 1990 Act, the HOME Program Regulations (at 24 CFR 92.2) define a community housing development organization as an organization that, among other things, “maintains accountability to low income community residents by:

- (i) Maintaining at least one third of its governing board’s membership for residents of low-income neighborhoods, other low-income community residents, or elected representatives of low-income neighborhood organizations. For urban areas, community may be a neighborhood or neighborhoods, city, county, or metropolitan area.; for rural areas it may be a neighborhood or neighborhoods, town, village, county, or multi-county area (but not the entire state); and
- (ii) Providing a formal process for low-income program beneficiaries to advise the organization in its decisions regarding the design, siting, development and management of affordable housing.”

Most CLTs qualify under this definition with little difficulty, but certification was made easier still by the Housing and Community Development Act of 1992¹, which specifically defines a community land trust as “a community housing development organization that [among other things]...

Has a board of directors which includes a majority of members who are elected by the corporate membership and is composed of equal numbers of (1) lessees, (2) corporate members who are not lessees, and (3) any other category of persons described in the bylaws of the organization; and

Is not required to have a demonstrated capacity for carrying out HOME activities or a history of serving the local community within which HOME-assisted housing is to be located. [*The full text of the federal definition is attached.*]

In the past, some public officials interpreted this language to mean that any organization that otherwise conforms to the statutory definition of a CLT is by definition a CHDO. However, other officials assumed that if a CLT is to be considered a CHDO it must first meet the basic CHDO requirements established by the 1990 legislation (except for the explicit exclusion regarding demonstrated capacity and history of service). In 2001, the HUD Office of Affordable Housing published a notice affirming the latter interpretation:

For the purpose of receiving CHDO set-aside funds to produce HOME-assisted housing, CLTs must undergo the same designation process as any other nonprofit organization seeking CHDO status (See CPD Notice 97-11, “Guidance on Community Housing Development Organizations (CHDOs) under the HOME Program.”). However, Section 233(f) of NAHA exempts CLTs from two of the requirements applicable to other CHDOs....²

Thus a CLT seeking certification as a CHDO is now required to show that at least one-third of its board of directors meets one or another of the tests deriving from the 1990 legislation.

A few PJs have treated the requirement as a matter of “performance,” asking the CLT to show, at the time it seeks CHDO certification, that at least one third of its board consists of people who are in fact “residents of low-income neighborhoods, other low-income community residents, or elected representatives of low-income neighborhood organizations.” A larger number of PJs, however, have treated the test as a structural matter, asking the CLT to show that its bylaws specifically *require* that at least one-third of its board be “residents of low-income neighborhoods, other low-income community members, or elected representatives of low-income neighborhood organizations.” In some cases, PJs have simply accepted an argument that can be made by some (but not all) CLTs: that their bylaws reserve a third of the seats on the board of directors for lessee representatives, all of whom are low-income when they first purchase their homes, and that another third of the board seats are reserved for general representatives who reside in low-income neighborhood(s) served by the CLT. A number of other PJs, however, have required CLTs to amend their bylaws to add an explicit requirement for one-third low-income representation in order to gain certification as a CHDO.

As noted in Chapter 5 of the *CLT Legal Manual*, these amendments have not replaced the basic tri-partite CLT board structure but have been attached as a kind of

overlay. For many, if not most, CLTs, the kind of electoral process described in the ICE's Model Bylaws cannot absolutely ensure the election of a board that will meet the low-income requirement. In practice, however, this overlay of one set of structural requirements upon another, has not been a problem. CLTs have tended to achieve strong representation of low-income people and neighborhoods within their boards of directors without having to modify the process by which board members are elected. The current version of the Model Bylaws (Article III, Section 6) charges the membership and board of directors with responsibility for seeing that the requirement is met – “in their actions regarding the nomination and election of directors and appointment of people to fill vacancies on the board of directors” – but does not say exactly how they are to fulfill the responsibility.

Conflict of Interest for Lessee Board Representatives. Section 92.356 of the HOME regulations has been read by some officials to prohibit lessee participation on the CLT's board of directors by any lessee living in a HOME-assisted housing unit. Even though the Rule explicitly states – at 92.356(f)(1) – that the conflict of interest provision “does not apply to an individual who receives HOME funds to acquire or rehabilitate his or her principal residence,” some officials have insisted, “just to be safe,” that a CLT limit participation on its board of directors to lessee representatives (and, for that matter, to general representatives) who have *not* been beneficiaries of HOME assistance.

If necessary, a CLT can take advantage of the fact that the regulations allow HUD to grant an exemption to this provision to any PJ that requests it. One of the factors which HUD must consider in deciding whether to grant such an exemption is “whether the person affected is a member of a group or class of low-income persons intended to be the beneficiaries of the assisted activity, and the exception will permit such person to receive generally the same interests or benefits as are being made available or provided to the group or class.” Since a CLT's lessees would typically fit this definition of a “class of low-income persons intended to be the beneficiaries” of the HOME program, there would seem to be strong grounds for an exemption allowing CLT lessees to serve on the CLT's board of directors (especially since the Housing and Community Development Act of 1992 includes a definition of the CLT that requires one-third of the CLT's board of directors to be “composed of” lessees).

Maximum Price of HOME-Assisted CLT Homeownership Units. Section 92.254(a)(2) requires that homeownership units subsidized with HOME funds be “modest housing,” which is defined, in the case of newly constructed or “standard” housing, as housing that has a purchase price not exceeding 95% of the median purchase price for the area, or, in the case of “acquisition with rehabilitation,” as housing that has an estimated value after rehabilitation not exceeding 95% of the median purchase price for the area. This limit has occasionally been a problem for organizations that have sought to create affordable homeownership opportunities in neighborhoods where it is difficult or impossible to acquire housing that can be sold for less than 95% of the median price for the area. In 1999, HUD's Office of Affordable Housing issued a publication entitled *Homeownership Options Under the HOME Program: A Model for Publicly Held Properties and Land Trusts* in which it was stated that one of the advantages of the CLT model was that, since the price of a CLT home would not include the value of the land, it

would be much easier to comply with the 95%-of-median price cap. Subsequently, however, those directly responsible for administering the HOME program have objected to this statement by the Office of Affordable Housing and have insisted that the value of land as well as improvements must be included in the amount that is to be compared to the 95%-of-median price. To our knowledge, this internal disagreement has never been resolved, which means that PJs that raise the question with HUD headquarters will receive the answer sanctioned by the HOME Program administrators.

Periods of Affordability. HOME-assisted rental housing must remain affordable for from 5 to 20 years, depending on the type of housing and the amount of HOME funds invested in it [92.252(e)], and the resale prices of HOME-assisted homeownership units must be kept affordable by means of either “resale or recapture requirements” for periods of from 5 to 15 years, depending on the amount of HOME funds invested in the units [92.254(a)(4)]. Perpetually affordable CLT housing of course exceeds these minimum requirements. Occasionally PJ officials have wanted to treat the minimums required by the HOME regs as though they are fixed requirements that may not be exceeded. However the regulatory language is completely clear. The requirement is that affordability must be preserved for “not less than the applicable period.” Participating Jurisdictions are given the discretion and authority to impose an affordability period lasting much longer than the minimum required by HOME.

Resale Price Requirements. The regulations state that when “resale requirements” are imposed on HOME-assisted homeownership units, they “must ensure that the price at resale provides the original HOME-assisted owner a fair return on investment (including the homeowner’s investment and any capital improvements) and ensure that the housing will remain affordable to a reasonable range of low-income homebuyers.” [92.254(a)(5)(i)]. HUD has not attempted to interpret this very general statement of principle into more specific, quantitative terms (as was done in a parallel situation by FHA: see below), and, to our knowledge, no CLT resale formula (of any of the various types) has ever been found to violate HOME’s general requirement.

Community Development Block Grant Program

Neither the CLT’s distinctive governance structure nor its distinctive approach to ownership has raised significant issues with regard to federal Community Development Block Grant (CDBG) regulations. CLTs are not mentioned by name in CDBG regulations. They are simply subject to the same rules that regulate the operations and projects of any other nonprofit producer of affordable housing. Even more than is the case with the HOME program, any significant issues for CLTs will spring from the guidelines established by states or municipalities for their CDBG-funded programs (though it is still common for local officials to avoid doing what they’re not accustomed to doing by claiming “CDBG regs don’t allow it”).

FHA Mortgages for CLT Homeowners

There is no absolute barrier to the use of FHA insured mortgages for the purchase of permanently affordable (resale-restricted) homes on land owned by community land trusts (CLTs). In fact, some such homes have been purchased with FHA insured mortgages. FHA regulations provide for both the mortgaging of a leasehold interest and for resale restrictions designed to preserve affordability. However, in the 12 years since CLTs first gained access to FHA insurance for their homebuyers, the process for gaining such access has become increasingly complicated, and the conditions on which such insurance is available have become increasingly incompatible with the basic CLT goal of preserving the affordability of owner-occupied homes. The most serious problems concern FHA's requirements regarding resale formulas and the CLT's right to enforce resale restrictions.

Resale Formula Issues. These issues involve the application of FHA regulations to the design of CLT resale formulas as these formulas determine the amount of return that can be realized by CLT homeowners when they sell their homes.

The current rule regarding the amount of money that the homeowner must be permitted to recover upon resale is stated in 24CFR Section 203.41. The section specifically permits resale restrictions for "eligible governmental or nonprofit programs." Paragraph (d)(1) of the Section states:

(1) Except as otherwise provided in the HOME Investment Partnerships (HOME) and the Homeownership and Opportunity for People Everywhere (HOPE) programs, the mortgagor may be prohibited from selling the property at a price greater than the price permitted under the program, or the mortgagor may be required to pay a portion of the sales proceeds to a governmental body or an eligible nonprofit organization, as long as the mortgagor is not prohibited from recovering:

- (i) The sum of the mortgagor's original purchase price, the mortgagor's reasonable costs of sale, the reasonable costs of improvements made by the mortgagor, and any negative amortization on a graduated payment mortgage insured under Sec. 203.45 of this part; and
- (ii) A reasonable share, as determined by the Secretary, of the appreciation in value which shall be the sales price reduced by the sum determined under paragraph (d)(1)(i) of this section.

These requirements – and FHA's rather restrictive interpretations of them – have resulted in a number of CLT resale formulas being rejected by FHA. Burlington Associates can provide more detail if FHA insurance becomes an issue for Arcata.

Enforcement Issues. Generally, FHA regulations require that properties with FHA-insured mortgages must be free of restrictions on transferability. As already noted, exceptions to this general policy are allowed in the case of restrictions that are a part of an "eligible governmental or nonprofit program." However, the CLT's ability to enforce such restrictions appears to be seriously undermined by Section 203.41(d), which states:

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“For purposes of paragraph (c) of this section, restrictions of the following types are permitted for eligible governmental or nonprofit programs, *provided that a violation of legal restrictions on conveyance may not be grounds for acceleration of the insured mortgage or for an increase in the interest rate, or 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 (at a reasonable rate of interest) of assistance provided to make the property affordable as low- or moderate-income housing* [emphasis added]....”

Some CLTs, in order to gain FHA mortgage insurance for their homebuyers, have adopted ground lease riders that accede to this limitation on the enforceability of the lease's resale restrictions. Again, Burlington Associates can provide more detail if necessary.

Attachment:
from the 1992 Housing and Community Development Act

H11966 **CONGRESSIONAL RECORD - HOUSE**
October 5, 1992

**SEC. 212. HOUSING EDUCATION AND ORGANIZATIONAL
SUPPORT FOR
COMMUNITY LAND TRUSTS**

(a) *COMMUNITY LAND TRUSTS.* --- Section 233 of the Cranston-Gonzales National Affordable

Housing Act (42 U.S.C. 12773) is amended -

(1) *in subsection (a)(2) by inserting "including community land trusts," after "organizations";*¹

(2) *in subsection (b), by adding at the end the following:*²

(6) COMMUNITY LAND TRUSTS. --Organizational support, technical assistance, education, training, and community support under this subsection may be available to community land trusts (as such term is defined in subsection (f) and to community groups for the establishment of community land trusts"; and

(3) *by adding at the end of the following:*

(f) DEFINITION OF COMMUNITY LAND TRUST.---For purposes of this section, the term "community land trust" means a community housing development organization (except that the requirements under subparagraphs (C) and (D) of section 104(6) shall not apply for purposes of this subsection)--

"(1) that is not sponsored by a for-profit organization;

"(2) that is established to carry out the activities under paragraph (3);

"(3) that--

"(A) acquires parcels of land, held in perpetuity, primarily for

¹ The subsection of the 1990 legislation that is here amended reads as follows: "(a) In General – The Secretary is authorized to provide education and organizational support and assistance in conjunction with other assistance made available under this subtitle... (2) to promote the ability of community housing development organizations to maintain, rehabilitate and construct housing for low-income and moderate-income families in conformance with the requirements of this title."

² Subsection (b) begins as follows: "(b) Eligible Activities – Assistance under this subsection may be used only for the following eligible activities..."

conveyance under long-

term ground leases;

"(B) transfers ownership of any structural improvements located on such leased parcels to the lessees; and

"(C) retains a preemptive option to purchase any such structural improvement at a price determined by formula that is designed to ensure that the improvement remains affordable to low-and moderate-income families in perpetuity;

"(4) whose corporate membership that is open to any adult resident of a particular geographic area specified in the bylaws of the organization; and

"(5) whose board of directors---

"(A) includes a majority of members who are elected by the corporate membership;

and

"(B) is composed of equal numbers of

(i) lessees pursuant to paragraph (3)(B),

(ii) corporate members who are not lessees, and

(iii) any other category of persons described in the bylaws of the organization."

¹ The language quoted here from the Housing and Community Development Act of 1992 was incorporated in early versions of the HOME program regulations. Unfortunately, although these specific provisions for CLTs remain a part of federal law, they are included in HUD's streamlined "Final Rule" only by reference. Buried within earlier federal regulations, these CLT provisions are harder to find, resulting in an increase in the number of federal state, and municipal officials who are not even aware that these CLT provisions exist. Relevant portions of the 1992 legislation are included in Appendix B.

² HOMEfires: Policy Newsletter of the HOME Investment Partnership Program, Office of Affordable Housing Programs, Vol. 3, No. 10, October, 2001.