

Comparison of Mechanisms for Restricting Homeownership to Achieve Longer-Term Goals

Mortgage vs. Deed Covenant vs. CLT Ground Lease

	Mortgage	Deed Covenant	Ground Lease
<i>What is the contractual means by which restrictions are imposed?</i>	A provision to recapture the original subsidy is secured by a lien on the property in the amount of the subsidy. These “soft” mortgages are subordinated to the conventional first mortgage.	A restrictive covenant is appended to the deed for land and house. (In condos, it is attached to the unit deed.)	Provisions are contained in the ground lease, regulating the resale and use of structures located on the land.
<i>What kinds of restrictions are imposed?</i>	The only restrictions that can be placed in a mortgage lien are subsidy recapture provisions, designed to reclaim the value of subsidies so these subsidies can be recycled for future uses. Restrictions on use, occupancy or resale cannot effectively be stipulated in a mortgage instrument.	Most deed restrictions control the price at which a unit may be resold, define the eligibility of the next buyer, and require continued occupancy of the unit by the current owner. A few delve into various “use” restrictions as well, but this is less common.	The ground lease contains the same kinds of restrictions on resale price, eligibility, and occupancy found in restrictive covenants. In addition, there are lease provisions regulating maintenance, insurance, mortgaging, subletting, and improvements (among other things).
<i>How long are restrictions designed to last?</i>	Mortgages can have terms of varying lengths. Typically, “soft” mortgages are limited to a maximum of 30 years – the typical term for a conventional first mortgage.	Most deed restrictions are designed to lapse after a relatively short period (e.g., 10 years), although some are intended to be permanent, i.e., “running with the land.” In almost every state, “perpetual” deed restrictions are considered invalid as a “restraint on alienation” or violation of the “rule against perpetuities.” Some states limit these restrictions to 30 years (sometimes less).	The lease typically lasts for a very long period of time (e.g., 99 years) and may be renewed at the option of the lessee.
<i>How legally enforceable are the restrictions?</i>	A recorded mortgage is a familiar and acceptable legal mechanism – and is commonly enforceable. As mortgages typically are limited to a maximum of 30 years, they are typically not subject to challenges as “restraints on alienation” nor are they subject to the “rule against perpetuities”.	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. (Enforceability rests on meeting legal tests of “privity,” “touch and concern,” and benefit to a nearby parcel owned by the same party who is imposing the restriction.) Some states have enacted laws explicitly sanctioning “perpetual” deed restrictions; others have not.	Because the lease term is finite (even if the lease is renewable) and because the lessor has a close and continuing connection to the restricted property, affordability restrictions in a lease are generally more enforceable for a longer period of time than those attached to a deed.
<i>What happens to affordability once the term of the restriction comes to an end?</i>	In appreciating markets, the affordability disappears at the time of resale and repayment of the mortgage.	Upon expiration of the covenant, all restrictions on affordability are removed. The property may then be sold for the highest price that the market will bear.	Upon expiration of the lease, either the lease is renewed (along with affordability controls) or the lessor takes possession of any structures located on the land.

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<i>How are restrictions on use, occupancy, condition, improvements, etc. monitored and enforced during the homeowner's tenure?</i>	Occupancy and use restrictions are typically not placed in mortgage instruments – as this is an unfamiliar use of mortgages. One of the reasons for this is the fact that it would be administratively costly to monitor compliance in such a practice. More importantly, it would be very difficult to find a first mortgage lender that will allow the holder of a “soft” second mortgage to exercise any meaningful remedies if the first mortgage is not in default.	It is rare for <i>any</i> monitoring to be done during the homeowner's tenure. It is assumed that, because a good title search will locate these restrictions and because a careful purchaser will not buy a property in violation of the same, deed covenants are “self-enforcing.” On those rare occasions when monitoring <i>is</i> done – and where a violation is noticed – the party imposing the restriction(s) may pursue court action to compel compliance. The enforcement of deed covenants is not as well established as the enforcement of leases, however.	The owner of the underlying land – i.e., the lessor – monitors the use and condition of the restricted property. The collection of lease fees and periodic inspections of the premises, allowed by the lease, provide “windows” on the lessee's performance. Procedures for remedying violations are embedded in the lease. As a last resort, the lessor may pursue a summary process for lease enforcement.
<i>How are affordability restrictions on pricing and homebuyer eligibility monitored and enforced at time of resale?</i>	As the mortgage instrument is a mechanism to assure <i>repayment</i> of the subsidy – to allow the subsidy to be recycled to another use – there are no affordability restrictions on pricing or homebuyer eligibility to be monitored. There is no provision for assuring that the home will be affordable or that an “eligible” buyer at resale will occupy it upon resale. Recapturing subsidies will not prevent subsidized homes from returning to the unrestricted market, with prices that are likely to be unaffordable for limited-income households.	Deed restrictions are typically assumed to be “self-enforcing.” Lawyers for the parties (or a title company) are expected to discover the affordability covenant and to warn that title will be clouded if the property is sold in violation of the covenant's restrictions on pricing and homebuyer eligibility. Alternatively, some covenants give a public entity or a nonprofit organization the first right to re-purchase the home at a formula-determined price, similar to the option in a CLT's ground lease.	At resale, the terms of the ground lease put the lessor in the middle of the transaction. The lessor either exercises an option to repurchase the home at the formula-determined price or approves the sale of the home from one income-eligible homeowner to another at the formula-determined price.
<i>What happens to affordability in a foreclosure situation?</i>	In the event of foreclosure, the mortgagee sells the property to whatever buyer they wish. Proceeds of the sale are used first to pay off the first mortgage. As proceeds allow, the “soft” second mortgage is then paid down.	Typically, the covenant is subordinate to the mortgage. In foreclosure, affordability controls lapse and the mortgage lender later resells the property for the highest price that the market will bear.	Under the “permitted mortgage” specified in the leases used by most CLTs, the lessor has right to cure defaults. If the option to cure is not exercised and the lender forecloses, affordability controls lapse. However, the lessor retains the land, along with a first right to re-purchase the house from the lender. The lessor may either buy back the house or charge a market-rate rent to any new owner to whom the lender sells the house.
<i>How are the costs of monitoring and enforcing these restrictions covered?</i>	Mortgages require little monitoring and are relatively easy to administer. In the case of resale, it is likely that a title search will reveal the recorded mortgage and the new buyer's lender will require	Assuming that any active monitoring or enforcement is done, the costs are typically borne by the agency or organization that imposed the covenant in the first place.	The lessor collects a monthly lease fee from all homeowners living on its land. The lessor may also collect a “transfer fee” at the time of resale.

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	that any unsatisfied mortgage be paid off or subordinated to the new first mortgage. This cost is paid as part of the buyer's closing costs.		
<i>What are the <u>disadvantages</u> of using this particular mechanism?</i>	<ul style="list-style-type: none"> • In appreciating markets, the affordability disappears at resale – often creating unfair “windfalls” for initial beneficiaries. • Recapturing subsidies will not prevent subsidized homes from returning to the unrestricted market – with unaffordable prices. And, often, the recaptured subsidy is insufficient to reduce the cost of the same (or similar) home to another household at the same income level. • Multiple layers of subordinate mortgages can create issues of order and priority and, thereby, complicate closings. • Occupancy, use and resale restrictions typically cannot be placed in mortgages. 	<ul style="list-style-type: none"> • Deed restrictions are <i>not</i> “self-enforcing”. There is no practical way to ensure enforcement without the on-going, methodical monitoring by a nonprofit or governmental agency. Title searches may not reveal the restrictions – and motivated buyers and sellers can easily “end run”. • Deed restrictions are effective for only a limited time. In many states, deed restrictions are limited by state statute to a maximum of 30 years (or sometimes less). 	<ul style="list-style-type: none"> • Although becoming more familiar, the CLT is still a relatively new concept. • An organization needs to be funded, staffed and maintain to carry the responsibilities of acting as lessor. • The unique ownership arrangement and the use of the ground lease add complexities to real estate transactions.
<i>What are the <u>advantages</u> of using this particular mechanism?</i>	<ul style="list-style-type: none"> • Using traditional legal documentation, mortgagees are familiar and acceptable to buyers and first-mortgage lenders • Mortgages are relatively easy to administer. • As they are typically limited to a maximum of 30 years, mortgages are typically not subject to challenges as “restraints on alienation” nor are they subject to the “rule against perpetuities”. 	<ul style="list-style-type: none"> • The restrictions on resale price assure that affordability is not lost for the duration of the deed restriction. • For the duration of the deed restriction, the benefit of initial subsidies has potential to benefit more lower-income households than just the initial beneficiary. • As deeds are used in majority of real estate transactions, this approach is familiar and relatively easy to understand. 	<ul style="list-style-type: none"> • The three-part Board structure assures that the interests of homeowner/beneficiaries, as well as the interests of the broader community are represented and protected. • Homeowners receive support – and are held accountable by CLT for hazards, defaults and misuse of the property. • Due to unique structuring of ownership, CLT is not subject to challenges on “restraint in alienation” or a violation of “rule against perpetuities”. CLT is only mechanism to create <i>permanent</i> affordability.