

Community Land Trust Foreclosure Model: From Sub-prime Mortgage to Permanent Affordability

The Problem

According to the Mortgage Bankers Association, foreclosure rates in 2007 were the highest since they started keeping track fifty years ago: over 2% of U.S. home loans were in foreclosure with the loan delinquency rate nearly 6%. In 2007 the number of mortgage foreclosures increased substantially, to over 200,000 mortgages per month according to RealtyTrac and that number is expected to increase in 2008.. Foreclosure rates were highest for adjustable sub-prime loans with over 5.25% in foreclosure whereas the prime ARM rate was just over 1% in foreclosure.

In the U.S. about 40 million (70%) homeowners have mortgages on their homes according to the Census. About 2 million of these mortgages are considered sub-prime, that is, the borrowers have less than perfect credit. Since these loans are deemed riskier it is probable that the interest rate is higher or some similar higher cost implication is a component (increased acquisition or insuring costs). Lower income households are able to get mortgages they otherwise would not with little money needed for a down payment or low “teaser” interest rates that adjust upwards over time. When these interest rates inevitably increase many households are not able to make their monthly mortgage payment.

Borrowers who miss their payment(s) and receive a notice of default need to take action to catch-up, get a new mortgage, renegotiate their mortgage, sell their home or go into default. Many elements influence the likelihood of default including loan to value ratio of the property, the amount of their home down payment, whether there are loan prepayment penalties or resets, and whether the interest rate is adjustable. The action an owner takes depends on their financial status, their lenders’ willingness to renegotiate and the local housing market. If owners are unable to make a change they will go into foreclosure. Whether they go into foreclosure depends on secondary liens, real estate tax default status, personal bankruptcy, external market valuation, and even simple desire to keep the home. Many nonprofit organizations offer foreclosure counseling to help such owners keep their homes but few groups have the financial resources to step-in. If a deed in lieu of foreclosure is not established, once a home is foreclosed upon often the owner can still sell the home, but many walk away before the bank takes full possession. After foreclosure the bank can resell the home to try to recover their investment.

Because foreclosures have become a national problem the federal government and some banks have begun to step-up and offer assistance such as fixing or lowering interest rates, extending the years of repayment in order to minimize monthly debt load, accepting less than what is owed, or allowing more time before foreclosure. However, only certain owners/borrowers are eligible for these programs. Many will fall between the cracks. Another solution is needed.

The Community Land Trust Solution

The community land trust model offers an alternative to foreclosure for many owners. According to the Institute for Community Economics a community land trust is a private non-profit corporation created to acquire and hold land for the benefit of a community and provide

secure affordable access to land and housing for community residents. In particular, CLTs attempt to meet the needs of residents least served by the prevailing market. CLTs make homeownership affordable by disconnecting the price of a house from the price of the land on which it sits. Since grant financing covers the cost of the land, the homebuyer only needs to pay for the house. In return for increased affordability the owner agrees to a reduced share of future home price appreciation. There are many models for sharing the appreciated value, each with pros and cons, but in the end the homeowner is able to buy a home when they otherwise would not have been able.

Community land trusts have been around for nearly forty years and have created over 6000 affordable housing units. According to a national study there are nearly 200 CLTs all across the country. CLTs have been established by local nonprofits, municipalities and citizens groups. In addition to sharing appreciation many other decisions need to be made about how to operate a CLT such as the geographic location to cover (specific neighborhood, city-wide, county-wide, state-wide), house values to pursue (how expensive compared to grants and incomes), household income levels to serve (percent of median income ex. 60%, 80%, 100%, 120%), foreclosure status (in default, in foreclosure, already foreclosed) and owner issues (employment status; credit issues).

With the foreclosure crisis, CLTs can step-in at anytime: when the owner is late, when the house is in foreclosure, after the foreclosure has been completed, or even after the bank has taken possession. The CLTs ability to acquire property will be a factor of their success in obtaining grants and bank financing, property values and their willingness to take the property. Financing is essential since the properties will be held in-perpetuity and they will need to be able to move quickly to acquire a property. In addition, the CLT has to have the organizational capacity to acquire property, counsel homeowners, pay for staffing and administer the program.

In order to operate the model, CLTs need to be able market it and explain it. Marketing is important because in many areas residents will not be aware of the organization even if the CLT has been around for years. When homeowners are in crisis they may not be willing to learn about a new organization or trust another agency trying to “help” them get a home. CLTs need to be able to notify homeowners at each phase in the process (notice of default, pre-foreclosure and foreclosure) that they are available to acquire the property.

CLTs also need to make sure that lenders know they are willing to take real estate owned by the banks to hold in the trust. This step should be easier since CLTs need to have good working relationships with banks to get financing in the first place.

Once CLTs have reached eligible owners, staff need to explain how the model works. Owners need to understand how much they may share in the appreciation, their maintenance responsibilities, monthly payment amounts and CLT staff involvement. The CLT model is not for everyone and some owners may not agree with the rules that will be imposed so staff need to be direct and provide written evidence of how the model works.

Diagramming the Process

A diagram of the process by which homes move toward and through foreclosure illustrates both the opportunities for CLTs and the complexities surrounding default and foreclosure issues. The diagram below is known as a “stock-and-flow” diagram. It portrays the flow of houses through a system of interconnected stocks (or levels) and flows (or rates), much like a set of bathtubs linked by drains and faucets. In the diagram, the stock variables are portrayed as rectangles. The flows are the blue arrows linking the levels. Each flow arrow is governed by a rate (the hourglass shape). Various exogenous variables influence the rates; those exogenous variables are printed in orange on the diagram and linked to the appropriate rates by dashed orange arrows.

The diagram is consistent with the verbal description above, and is read from left to right, starting with “Mortgaged Single-Family Home.” Its purpose is to help clarify the process and make it easier to identify key variables that influence the potential flow of housing units into CLT ownership. For instance, the model shows that CLTs can acquire housing units at four points in the process: when the homeowner has received a notice of default, when the home is in foreclosure, when the foreclosure has been completed, and when the home is in bank ownership. The objective of keeping homeowners in their homes argues for early acquisition by CLTs, before the foreclosure process is completed. However, homeowners may resist shared-equity ownership solutions until they feel that other options are exhausted, making it harder for CLTs to act in time. The diagram is intended to promote discussion and better understanding of these and other dynamics of the process.

