FannieMae

3900 Wisconsin Avenue NW
Washington, DC 20016-2892
Phone (202)752-7000

Fannie Mae Guidelines on the Valuation of a Property Subject to a Leasehold Interest and/or Community Land Trust (CLT)

Leasehold Interest

Leasehold interest is the right to the use and occupancy of real property by the existence of a lease agreement. The lessee (tenant or renter) enjoys these rights for a stipulated period of time, subject to the payment of rent and other conditions. The valuation of a leasehold interest may require complex analysis, so the appraiser should be prepared to develop a thorough, clear, and detailed narrative for the addendum section that describes the lease agreement's terms and conditions and discusses their impact, if any on value and marketability.

The leasehold box should be checked if the house being appraised is on leased land or is subject to what is termed a "ground rent". In brief, ground rent is the rent paid for the right to use and occupy land according to the terms of a ground lease. Although this is uncommon in most areas, there are areas of the United States where ground rents are very common. The terms of the ground lease should be identified and the effect of the lease analyzed in a narrative discussion attached as an addendum to the report.

The appraiser should use sales of properties that have similar leasehold interests. When adequate, closed leasehold comparables are available, the appraiser will report them in the sales comparison section of our report forms to arrive at an opinion of the market value of the leasehold estate for the subject.

However, the appraiser may not have sales available which have the same lease terms. In such cases, the appraiser may use the most similar sales available with different lease terms or even fee simple sales. The appraiser must make an appropriate adjustment (if any), on the sales comparison grid, to reflect the market reaction to the different lease terms or property rights appraised. The appraiser should explain why the use of these sales was appropriate.

Forms 1004, 1025 and 1073 have an adjustment line on the sales comparison grid. Forms 2055 and 2065 do not have a specific adjustment line, therefore the appraiser must use one of the blanks lines for making the appropriate property rights adjustment.

Community Land Trust Properties

Note: Community Land Trust Mortgage Loan Transactions are eligible under Part V, Chapter 3, Section 301.05 of the Fannie Mae Selling Guide**. The Lender must contact their Customer Account Manager to arrange for specific terms and conditions to be added to their Master Agreement to deliver this type of mortgage. In all cases the land records of the subject property must include adoption the terms and conditions incorporated in the Fannie Mae approved *Uniform Community Land Trust Ground Lease Rider.***

Community Land Trusts ("CLT"), typically, are non-profit organizations that acquire land for a variety of purposes including, but not limited to facilitating home ownership among lower income individuals and families. Similar to other leasehold properties, CLT's retain ownership of the land. CLT's offer a long term (99 year) , renewable ground lease to the owner of the improvements. By removing the cost of the land from the transaction, the home may be purchased at a lower cost, thereby increasing affordability. CLT's are established in communities to offer home ownership opportunities and to create and maintain a permanently affordable housing stock. Therefore, the CLT ground lease may contain restrictions on purchaser eligibility and restrictions on the resale of the property.

As the development of Community Land Trust (CLT) properties expands in the United States, the question about how to appraise these individual properties has arisen. Chapter V, of this Selling Guide, details our general appraisal requirement for analyzing the property appraisal aspects of conventional, conforming, one to four family properties. This section provides additional guidance to the appraiser and lender on the appraisal process for properties located on land held by a CLT.

Like other non-profit affordable housing developers, community land trusts, use grant, gift and subsidy dollars to acquire the land and otherwise write down development cost to an affordable level. The CLT structure is unlike traditional affordable homeownership programs where the subsidy is a) included in the selling price, b) secured by "soft second' liens on the homebuyers property and c) due on resale. The selling price of a CLT home typically does not include the subsidy amount used to acquire the land. Therefore, the sales price to the CLT homebuyer may be less than the leasehold interest in the property.

Selection of Appraiser

As is the case for all mortgages delivered to Fannie Mae, the lender is responsible for the accuracy of both the appraisal and its assessment of the marketability of the appraisal. As indicated in the Selling Guide, Part V, Chapter 1, Section 101, " Lenders are responsible for the selection of appraisers, are accountable for their performance- and must take appropriate steps to ensure that the appraiser is qualified to perform appraisals for the particular types of property that the lender intends to refer to the appraiser." It follows that an appraiser that is to appraise a CLT property must have knowledge and experience with the tools that are necessary to value this type of property (such as direct capitalization and market derivation of capitalization rates).

Appraisal Methodology

The appraisal of a CLT property requires the appraiser to analyze the CLT property, subject to the ground lease (i.e. leasehold estate) as security for the mortgage. Fannie Mae and the Institute for Community Economics have reached agreement on a Uniform Community Land Trust Ground Lease rider, to be attached to a CLT ground lease for mortgages that will be sold to Fannie Mae. This rider amends the CLT ground lease to provide for the removal of resale and other restrictions that would hinder the mortgagee's ability to dispose of the property upon foreclosure.

Since the CLT typically subsidizes the sales price to the CLT homebuyer, that price may well be less than the market value of the leasehold interest in the property. Since the *Uniform Community Land Trust Ground Lease rider* removes these resale and other restrictions for the mortgagee, it is important that the appraised value of the leasehold interest in the property be well supported and correctly developed.

The appraiser must develop an 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 the Uniform Community Land Trust Ground Lease rider removes if the mortgagee must dispose of the property upon foreclosure. The lender is required to advise the appraiser that the appraisal report must contain the following statement:

> **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 Lease rider.**

Because of the dynamics of CLT properties, the appraiser's first step should be to determine the fee simple value for the subject property using the sales comparison analysis. The second step is to determine the leased fee value of the ground lease. The final step involves deducting the leased fee value from the fee simple value to arrive at the leasehold value.

Determining the Property's Fee Simple Value

The first step in the valuation process requires the appraiser to develop an opinion of the fee simple value of the subject. Therefore, it is expected that the appraiser will use sales of fee simple ownership of similar properties.

Use of sales without a ground lease (fee simple) is preferable. However, the appraiser may use sales of leasehold properties but they will require adjustment based on their lease to reflect a fee simple interest. CLT sales may be available in the community and, if so, they should be specifically discussed in the appraisal report. However, CLT sales may not be appropriate in developing value since the prices are normally limited by restrictions in the ground lease and would therefore not be comparable to the hypothetical condition of the appraisal, which assumes a leasehold interest without resale and other restrictions.

Determining the Capitalization Rate

The most direct method for determining the capitalization rate is by extraction from the market. This normally requires an active market with sales of fee simple ownership properties and sales of comparable non-CLT properties subject to a ground lease. To extract the capitalization rate, (all things being equal) the appraiser divides the non-CLT annual ground rent by the difference in sales price of the comparable fee simple and leasehold properties.

There is another method for determining the capitalization rate that is especially applicable when no sales of comparable non-CLT properties subject to a ground lease are available. This method compares alternative low risk investment rates such as long term bond rates. The appraiser should select a rate that best reflects a "risk-less" rate (safe rate), loss of liquidity, management compensation, and compensation for investment risks assumed.

Determining the Property's Leasehold Value

Direct capitalization of the ground rent is used to convert the annual income from the CLT ground lease into an indicated leased fee value by dividing the income by a market-derived capitalization rate. Subtracting this leased fee value from the estimated fee simple value of the subject property leaves the leasehold value. This method does not require documentation of the actual land value, as do other methods.

The appropriate steps would be:

- **Step 1.** Determine the annual contract rent due the CLT under the terms of the ground lease,
- **Step 2.** Determine the appropriate market capitalization rate for the ground rent,

Step 3. Divide the annual rent by the market derived capitalization rate to indicate the leased fee value.
Step 4. Subtract the leased fee value from the estimated fee simple value to indicate the subject property's leasehold value.

Example (for illustrative purposes only):

- Annual rent due the CLT for ground lease: $300
- The market divided capitalization rate: 5.75%
- $300 divided by 5.75% equals $5,217.39 ($5,200 rounded)
- If the fee simple property value were $100,000; the indicated leasehold value of the property would be $100,000 minus $5,200 or $94,800. The final opinion of value reported is $94,800.

Appraisal Reporting

The CLT appraisal should be reported on Fannie Mae Form 2055. "Leasehold" property rights appraised should be indicated in the "SUBJECT" section of the report. The CLT ground rent should be reported in the "Special Assessment" area of the same section. The appraisal should also indicate "Prop.Rights" as the "FEATURE" and "Fee Simple" as the "DESCRIPTION" for the "SUBJECT" in the adjustment grid of the "SALES COMPARISON ANALYSIS" section. The adjustment grid should then estimate the Fee Simple value for the subject property. In the "Summary of sales comparison and value conclusion" area of this section of the report, the following items need to be present in addition to the normally required discussion (many times this area will have to be continued on the addendum for CLT appraisals):

1. Indicated Fee Simple Value for the Subject
2. Indicated Leasehold Value of the Subject (Fee Simple less the Leased Fee)
3. The statement "See attached addendum for development of capitalization rate and expanded discussion of sales used and considered."

At the bottom of Page 1 of the form, the "subject to the following repairs, alterations or conditions" box must be checked with the statement "see attached addendum for hypothetical condition" added at the end. If the subject property is not completed, the "subject to completion per plans and specifications ..." box should **also** be checked.

The leasehold value should be indicated as the value on the bottom line of page one and again on page three of the report.

Prepared By:

Joseph L. Minnich III
Senior Business Manager
Single Family Mortgage Business
Washington DC

Kevin R. Hickey
Underwriting Consultant
Credit Policy
Washington, DC

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