California Community Land Trust Network

# Guide to Capital Improvements Policies

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California Community Land Trust Network

Perpetual Home Affordability-Stewardship-Community Control

# Guide to Capital Improvements Policies

## TABLE OF CONTENTS




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# INTRODUCTION

In the conventional housing market, the unrestricted resale price of a home reflects much of the value a homeowner adds through improvements that enhance the home's comfort, appearance, or utility. Of course, such investments are seldom recognized dollar for dollar in market-rate housing, as the value of such improvements is always subject to the forces of demand and depreciation.

For price-restricted Community Land Trust (CLT) homes (and other types of shared equity housing), resale price restrictions do not automatically allow for the recognition of such investments. Therefore, additional policies are necessary to recognize the contributions of homeowners who add improvements that enhance the home's utility. Furthermore, many CLTs choose to adopt such policies to encourage CLT homeowners to invest in their property in ways that suit the CLT's purposes as well.

These policies have often proved thorny in practice, as the following questions illustrate:

- How do you distinguish between replacements or repairs—which are necessary to retain or restore the value of the home—and capital improvements, which add value beyond the original value of the home?
- How do you distinguish between improvements that increase the utility of the home and those that may be considered personal luxuries?
- How do you place a monetary value on improvements made by a homeowner after purchasing a CLT home?
- How do you negotiate the process for approving and valuing improvements so that homeowners receive a fair return on their investment when reselling a CLT home?
- And how do you design an improvements policy that is neither intrusive on the homeowner nor burdensome for the CLT charged with administering it?

This guide is intended to provide some useful pointers for designing and implementing capital improvement policies. It builds upon the earlier work of Kirby White and John Emmeus Davis, who have written most extensively about this subject. Chapter 12 of the 2011 *CLT Technical Manual,* authored by Kirby and published by Grounded Solutions Network, addresses the use of "itemized" resale formulas, which increase or decrease the amount of the allowable resale price based on the homeowner's investment (or lack thereof) in the home. Chapter 3 of *Shared Equity Homeownership,* authored by John and published in 2006 by the National Housing Institute, offers perhaps the most extensive discussion in the CLT literature on the topic of capital improvements.

The Model Ground Lease, produced by the National CLT Academy in 2011 and published by the National CLT Network (now Grounded Solutions Network), includes several provisions that speak directly to the way that post-purchase capital improvements are to be reviewed, approved, and valued. We will be referencing these provisions in the coming discussion since any improvements policy must be based on and consistent with the ground lease that is executed between the CLT and its individual homeowners.

Additionally, we will be drawing on selected capital improvement policies and practices from four CLTs: Champlain Housing Trust, Community Justice Land Trust, Homestead Community Land Trust, and Interboro Community Land Trust, which are summarized in the Appendix. Some of these policies address "big ticket" maintenance items, particularly those related to protecting the building envelope, which would otherwise be disincentivized under a resale price restriction. We should note that maintenance and repair of CLT owner-occupied homes is a topic that extends far beyond the scope of this guide.

Lastly, we should note that this guide is framed in the context of single-family owner-occupied housing. Other forms of shared equity homeownership, including housing cooperatives, condominiums, and attached townhomes, require a similarly thoughtful approach, which we will address in an abbreviated fashion toward the end of this document.

# GOALS OF PROGRAM DESIGN

The design of a capital improvements policy inevitably involves an attempt to resolve a cluster of goals that are, to a greater or lesser extent, in tension with each other. How can a CLT provide financial incentives for utility-enhancing improvements without jeopardizing affordability? How can a CLT provide individualized attention to a particular homeowner's needs without creating an undue administrative burden on the CLT's staff? These goals set the yardstick against which proposed policies can be measured, with each CLT needing to make its own calculation on how best to strike a balance that best fits both their organization and the residents they serve.

## Maintain Affordability

While most CLTs want to incentivize utility-enhancing improvements that are made by homeowners after purchasing a resale-restricted home, this cannot come at the expense of maintaining affordability for subsequent homebuyers. As such, CLTs should consider incorporating into their capital improvements policy an upper limit on the amount of credit provided to the seller to ensure an affordable purchase price for subsequent low-to-moderate income homebuyers.

## Maintain Quality

Maintaining the quality of the structure is an essential element of successful CLT stewardship. CLTs have an interest in seeing that any post-purchase improvements desired by their homeowners will be constructed in what the model ground lease calls a "professional manner." Indeed, one of the reasons that CLTs insist on reviewing proposed improvements before they are made is to ensure that they will not compromise the utility, legality, or structural integrity of the building.

This commitment to preserving the quality of CLT homes means that an improvements policy often overlaps with a CLT's policies and practices concerning ongoing maintenance and repairs. To avoid discouraging homeowners from investing in necessary "big ticket" maintenance and repair items like replacing a roof or furnace, some CLTs incorporate selected replacements into their capital improvements policies, giving homeowners a credit for them when calculating the resale price.[1]

## Improve Utility

These improvements—or replacements—that add to the utility of the home for both current as well as future residents can include, but not be limited to, the following:

- **Improving building performance:** This includes the replacement of mechanical systems, insulation, window replacement (where there is an increase in R-Value), addition of renewable energy systems (solar panels).
- **Increasing flexibility of use:** This includes adding a bedroom (accommodating larger families), adding a first-floor bathroom (good for any number of reasons), or making modifications to create wheelchair accessibility (visibility, housing for the lifespan).
- **Improving health outcomes:** This includes air filtration systems (to improve indoor air quality), soil remediation (to enable vegetable gardening), and noise mitigation measures (where housing is located in high noise areas).
- **Improving durability of the home:** This includes improvements to the building envelope (such as siding and roof replacement) and structural modifications to improve structural integrity. *[Note: This illustrates some areas of overlap with maintenance concerns.]*

## Promote Transparency

For a capital improvements policy to be effective in practice, it must be written and explained in a way that is clearly understandable to homeowners, so they can make fully informed decisions about improving their homes. The costs associated with making capital improvements involve a substantial investment of household finances. Therefore, transparency regarding eligible improvements and likely return on investment is essential to a well-crafted policy.

Additionally, transparency is an essential component of the legal defensibility of the policy itself, as full disclosure of (a) what improvements will be allowed, and (b) how they will be valued will reduce the likelihood of legal challenges down the road. Finally, transparency reduces the likelihood of conflict between the homeowner and the CLT, because everyone clearly understands the rules of the game.

[1] A complete discussion of maintenance issues is far beyond the scope of this guide. CLTs should, however, consider adopting a separate maintenance policy that might include any or all of the following: (a) a description of "carrot and stick" approaches to proper maintenance, (b) the establishment of stewardship funds (pooled or individualized) to cover all or part of the cost of repairs, (c) the identification of sources of subsidy funding to cover repairs too costly for homeowners to manage, and (d) the targeted repurchasing of homes by the CLT itself so it can deal with significant deferred maintenance issues.

Before initiating a costly repair, replacement, or improvement project, one should be mindful of the homeowner's reasonable desire to know what return, if any, they are likely to have on their investment. And at the same time, one should be mindful that even market-rate homeowners have little precision as to the actual return on their investment for such items other than the expectation that a home kept in good repair, and with desirable improvements made, will command a higher price on the open market.

## Reduce Administration

Capital improvement policies can be very burdensome to CLT staff members, particularly those policies that require approval of submitted building plans and individualized estimates of credits to be given. As such, it may make sense for smaller CLTs to implement schedule-based approaches that provide clarity up-front as to what improvements are allowed and what percentage of costs will be credited (subject to depreciation). When a CLT implements a schedule-based approach for pre-approved improvements, the CLT will still want to know what specifically is being proposed and have a chance to say "no" prior to construction if it appears that the improvement is not going to be constructed appropriately.

Larger CLTs (such as the Champlain Housing Trust), on the other hand, may have the in-house capacity to do case-by-case reviews, and can successfully implement individualized approaches.

# ISSUES AND OPTIONS IN DESIGNING A CAPITAL IMPROVEMENTS POLICY

While there is great variability in how capital improvements policies are written, there are five core questions that all must address:

1. What constitutes an "improvement" (as opposed to a repair or replacement)?
2. How should proposed improvements be reviewed/approved?
3. Which improvements should be rewarded?
4. How are improvements valued?
5. How is compliance monitored and enforced?

## What Constitutes a Post-Purchase Improvement?

**Definition.** A post-purchase capital improvement is generally defined as an addition or change that increases a building's value, increases its useful life, or adapts it (or a component of the property) to new uses. It is distinguished from maintenance and repairs, which are generally one-time expenses incurred to keep your property habitable and in proper working condition.

**Challenges.** Some items can be difficult to categorize. For example, a roof replacement extends the useful life of a home but a roof is also considered a routine component that requires maintenance and eventual replacement. And how might you characterize a furnace replacement, another “big ticket” item with a finite lifespan, where the replacement is significantly more energy-efficient than its predecessor?

**Model Ground Lease.** The 2011 CLT model ground lease[2] addresses maintenance obligations and post-purchase construction approval requirements but does not address the financial implications of either. It does not use the term “capital improvement” per se, but implicitly describes them by listing the homeowner modifications which require the written consent of the CLT to the home, namely construction which either (a) increases the footprint of the structure, (b) increases the square footage of the structure, (c) increases the height of the structure, or (d) adds a new structure to the leased premises. The model ground lease also requires the homeowner to maintain the home and leased land in a safe, sound, and habitable condition, in full compliance with all laws and regulations, and in the condition required to maintain required insurance coverage (Sections 4.2 and 7.5).

**Considerations in Design.** In designing capital improvements policies, it is therefore important to set out a clear definition of capital improvements, which can be based on, but not necessarily limited to, the above-described definition. Additionally, it is generally a good practice to provide a list of eligible improvements, to provide clarity as to what is and isn’t covered by the policy. The Community Justice Land Trust defines capital improvements as any post-purchase construction completed in compliance with Section 7.3 of the model ground lease. The Homestead CLT and Interboro CLT policies, on the other hand, provide a detailed listing of eligible items, as well as the rationale for their inclusion. It can be thorny in practice when a policy leaves it to the discretion of CLT staff to determine what is or isn’t an eligible improvement, which in turn can lead to inconsistent and arbitrary decision-making, and to conflict with homeowners.

## How Should Proposed Improvements Be Reviewed and Approved?

**Why Is This Important?** First and foremost, the CLT has an interest in reviewing proposed improvements to ensure that they will be done in a quality manner and in full compliance with applicable laws and regulations. Second, the CLT has an interest in determining which projects will either (a) be permitted in the first place (does it add utility or is it a luxury?), and (b) whether value (and how much) should be added to the allowable resale price? Finally, the CLT has an interest in ensuring that capital improvements do not compromise the marketability of the home when it comes time to resell to another low-income homebuyer.

**Model Ground Lease.** In Section 7.3, the 2011 CLT model ground lease sets out the requirements for homeowner modifications which require the written consent of the CLT to the home, namely construction which either (a) increases the footprint of the structure, (b) increases the square footage of the structure, (c) increases the height of the structure, or (d) adds a new

[2] https://groundedsolutions.org/sites/default/files/2018-11/2011%20Model%20Ground%20Lease%20and%20Commentary.pdf

structure to the leased premises. All construction, whether it requires approval or not, is subject to the requirements that (a) all costs shall be paid for by the homeowner, (b) the work shall be done in a professional manner and shall comply with all applicable laws and regulations, and (c) any changes should be consistent with permitted uses as described in Article IV.

Furthermore, Section 7.3 describes what needs to be included in a written request to the CLT, including (a) a rationale for undertaking the project, (b) a set of construction drawings, (c) a list of materials (and quantities), and (d) a description of who will do the work. Within two weeks of receiving the request package, the CLT shall either approve or provide a written explanation for why the request is denied. Finally, the homeowner must provide copies of all necessary building permits prior to the start of construction.

**What triggers the review process?**
There are a variety of circumstances that can trigger the review process. One is found in the set of criteria described in the model ground lease pertaining to construction that changes the dimensions of the structure or adds another structure to the leased premises. Another is the requirement for a building permit. A third could be the cost of improvements to be made, where, for example, Homestead CLT sets a minimum value of $1,000 for improvements requiring review -- which makes it simpler for homeowners to do minor improvements, though at the expense of being eligible for an improvements credit.

**Options for Approving and Valuing.** In *Shared Equity Homeownership*, John Emmeus Davis identifies four groupings for how CLTs handle the review and approval of proposed improvements, based on (a) whether prior approval by the CLT is required, and (b) whether an increase in value will be credited to the homeowner's equity when she resells her CLT home.

- *Option 1 - Approval not required, value not added.* This is the simplest one. Homeowners are free to make modifications, subject to local building and zoning codes, but no credit is given. The downside here is that there is little incentive for the homeowner to make improvements — unless they are planning to stay for a very long time and/or leave their home to their children.
- *Option 2 - Approval not required, value is added.* This is a list-based approach where homeowners are free to make any improvements that are on the CLT's pre-approved list. This approach provides clarity to the homeowner with regard to improvements that can be made; however, it still requires the CLT to address the issue of proper valuation.
- *Option 3 - Approval is required, value is not added.* Many CLTs prefer to have approval rights over selected improvements to ensure that the structural integrity and marketability of the building are maintained. This protects against such problems as the removal of a load bearing wall by an insufficiently skilled "do-it-yourself" homeowner.
- *Option 4 - Approval is required, and value is added.* This is the most common approach, where the homeowner submits building plans to the CLT for approval prior to constructing improvements. At the time of approval, the CLT may also calculate the credit amount that will be added to the homeowner's equity or may defer the calculation of credit until the appraisal at the time of resale.

**Considerations in Design.**
The more detailed the review and approval process required by a CLT's ground lease and improvements policy, the greater will be the administrative burden that is placed on the CLT. It is therefore important that the review and approval process be designed in a way that matches staff capacity of the organization.

For example, for CLTs with either a small number of staff or where there is a lack of in-house construction expertise, there may be a greater reliance on city building inspection departments to verify that post-purchase construction is done in a professional manner. In the alternative, these CLTs could contract with a construction professional to provide review services and make recommendations to CLT staff.

Additionally, schedule-based approaches which specify eligible improvements can reduce staff time in deciding which improvements should receive a credit. This approach also provides clarity to homeowners in deciding which improvements they may want to construct.

Where no credit is to be provided, CLTs should be mindful of minimizing the burden on homeowners, requiring only those plans and estimates that are necessary for the CLT to make a determination that the integrity, affordability, and marketability of the building will be preserved.

Where a credit is provided that is based on the cost of the proposed improvement, it may be prudent to require homeowners to solicit more than one bid, to make sure that the work is being done at prevailing market rate construction pricing, and reduce unnecessary upward pressures on resale pricing. Interboro CLT, for example, requires the submission of three bids as part of their review process.

Finally, it is important to provide clear criteria for circumstances where the CLT denies proposed improvements. For example, the Community Justice Land Trust's capital improvements policy requires the CLT to provide a written statement whenever improvements are denied, which must delineate how the proposed improvement (a) compromises affordability to future buyers, (b) undermines the homes durability, livability, or structural integrity, or (c) creates unsafe conditions on the lease land or the home.

## Which Improvements Should Be Incentivized?

**Why Is This Important?** The use of incentives gets to the heart of what type of post-purchase improvements a CLT would like to see constructed. Without incentives, resale price restrictions would discourage homeowners from making any major improvements, since it is likely that little of their investment would be returned to them at the time of resale (depending, of course, on the resale formula that a particular CLT has adopted). Incentives signal to homeowners which improvements the CLT believes will benefit the building across generations of homeowners, as well as enhance the physical accessibility of the home. And conversely, where no incentives are provided, a CLT signals its intention to discourage those improvements from being constructed.

How do you distinguish between improvements that increase the utility of the home (such as an extra bedroom or bathroom) and those that are more properly deemed discretionary amenities (such as a jacuzzi in the bathroom or a wet bar in the basement)? To address this concern, CLTs will often list items eligible for a financial credit at resale and those that will not.

**Model Ground Lease.** The model ground lease provides four variations on a resale price formula (appraisal-based, indexed, and fixed-rate formulas), none of which provide specific financial incentives for improvements to be constructed. For appraisal-based resale price formulas, there is a possibility of some return on investment in capital improvements, as the homeowner would receive 25% of the increase in appraised value, some of which would be attributable to improvements made. Indexed and fixed-rate formulas do not recognize the value contributed by capital improvements.

**Improvements Incentivizing Utility.** As described above, there are categories of improvements that can improve, which some CLTs have chosen to incentivize in their capital improvement policies. Measures to improve a building's energy efficiency, reducing monthly utility costs, increasing comfort, and lowering the carbon-based impacts of operating the home constitute one example. Accessibility modifications expand opportunities for purchasers with disabilities, and also enable homeowners to more successfully age in place in their CLT home. Adding a bedroom expands opportunities for families with children and intergenerational households. Air filtration systems can have a significant health benefit for persons with respiratory illnesses. Lastly, improvements that enhance the structural integrity of the home, as well as protecting the building envelope, improve the durability of the home, thereby ensuring that the home will be able to house multiple generations of homeowners.

Champlain Housing Trust's capital improvements policy adds improvements that might not appear in other CLT's policies, such as adding a garage, finishing a basement, remodeling a kitchen, and adding a fireplace or deck. Some CLTs would consider some of these items a "luxury"; others would encourage them, believing they add to the livability of the home and enhance the living experience of the families that reside there.

**Disincentivizing or Prohibiting "Luxury" Improvements.** More than anything else, CLT homes must remain affordable across generations to homebuyers of modest means. Therefore, improvements that are not focused on increasing utility — and which would add significantly to the resale price if a homeowner received a credit for installing them — will generally not be incentivized. In such cases, a CLT's policy may be either to deny them outright or to allow the homeowner to make the improvement without granting the homeowner a credit on resale. Typical examples of these "luxury" improvements would be a swimming pool or a hot tub, where providing a financial incentive would serve to make the home unaffordable to the next homebuyer.

**Capital System Replacement Upgrades.** Homestead CLT includes a category of "capital system replacement upgrades" in its policy, which in addition to incentivizing replacements that result in upgrades to safety and energy efficiency, also includes incentives to protect weather sealing of the building envelope. In the absence of a separate maintenance and repair policy, a CLT could choose, such as in Homestead's case, to incorporate certain replacement items that both maintain and enhance the quality of the home, to better serve multiple generations of occupants

**Considerations in Design:** A schedule-based approach provides the clearest guidance to homeowners on which improvements will be incentivized through the issuance of credits at resale. This is the approach taken by both the Homestead CLT and the Interboro CLT. Other CLTs provide general language as to what types of improvements will receive a credit (such as Champlain Housing Trust) but leave it up to case-by-case evaluations by their staff to determine whether a proposed improvement will qualify for a credit.

Overall, scheduled-based approaches will provide the greatest amount of clarity to homeowners, and help to reduce conflicts that can arise when homeowners disagree with discretionary staff decisions. But even with a clearly detailed list of incentivized improvements, it still is advisable to include an appeal process, as it is always possible that a utility-enhancing improvement may have been omitted.

## How Should Improvements Be Valued?

**Why Is This Important?** It is no simple manner to place a value on an incentivized improvement in a resale-restricted home. Should a homeowner receive the same amount of credit for an improvement constructed two years ago versus one done 20 years ago? And should all improvements be valued the same, relative to the cost of construction?

Market-rating housing does not have to deal with these complex questions regarding setting a resale price. Valuation "comes out in the wash" at the time of resale, where improvements are just part of the overall package reflected in market-rate pricing.

For CLT homes subject to resale price restrictions, the valuation becomes an issue of paramount concern, because the allowable return on investment (i.e., the improvements credit that is added to a homeowner's equity at the time of resale) will be a primary determinant in a homeowner's calculation of whether or not an improvement will be undertaken. The greater the percentage of costs recouped at resale via the improvements credit, the greater will be the incentive for constructing the improvement.

**Model Ground Lease.** As mentioned above, none of the variations of the resale formula provide for the specific valuation of capital improvements. Appraisal-based formulas recognize 25% of the value of capital improvements at the time of resale, while indexed and fixed-rate formulas provide no recognition of the value contributed by capital improvements. Under these approaches, there is simply no way to know at the time the improvements are constructed what the return on the homeowner's investment will be.

**Design Consideration #1: Options for Valuation.** There are two ways that valuations for improvements can be made.

*Schedule-based approaches* associate a percentage of costs to be credited for each listed improvement, along with an associated depreciation factor. This provides a very high degree of predictability as to return on investment; however, it does penalize do-it-yourself efforts, where only actual out-of-pocket costs are recognized. This does, in some ways, approximate the appraisal-based approach in the way that the percentage of costs is allocated. For example, a first-floor bathroom would get a higher percentage of costs credited just as an appraiser would favorably value that improvement.

Homestead CLT and Interboro CLT take a schedule-based approach, providing dollar-for-dollar credit for listed improvements, subject to depreciation. Depreciation schedules vary for each type of improvement. This provides a high degree of certainty as to return on investment to the homeowner prior to constructing the improvement.

*Appraisal-based approaches* focus on the increase in market value resulting from the improvement. One approach is to conduct an appraisal each time an improvement is made. This can add significant expense if multiple improvements are made during the period of ownership. Another approach is to appraise all improvements at the time of resale. Both provide a low level of predictability as to return on investment, with valuation occurring only after work is completed (and sometimes many years later). Additionally, appraisals of the value added by improvements can be both inexact and inconsistent, which can result in differing valuations for the same types of improvements.

Champlain Housing Trust takes an appraisal-based approach, which takes place at the time of resale and is focused on the incremental value added to the home by the improvements. While providing a low degree of certainty to the homeowner as to return on investment prior to constructing the improvement, it does provide the significant benefit of offering credit for do-it-yourself improvement projects.

**Design Consideration #2: Protecting Affordability.** All capital improvement policies should consider including a “safety valve” feature to protect the affordability of the home at the time of resale. It is conceivable, for example, for a homeowner to implement all improvements for which a credit is authorized which can have the unintended consequence of pushing the resale price far beyond the means of income-eligible buyers. An upper cap that keeps the home affordable to low-to-moderate income buyers is an essential component of a capital improvements policy.

One approach (utilized by the Homestead Community Land Trust) is to establish an upper cap on the resale price where the monthly housing costs of the purchaser should not exceed 33% of the gross income for households (adjusted for family size) at 75% area median income (AMI). The AMI should be adjusted to fit the goals of each individual CLT.

While the cap provides protection for affordability to the next purchaser, it does reduce the predictability as to the return on investment for the current homeowner. However, with the assistance of a CLT staff person, homeowners should be able to get a pretty good sense of whether they might bump up against the affordability cap, and thereby avoid big surprises at the time of resale.

## How Should Compliance Be Monitored and Enforced?

**Why Is This Important?** Once an improvement has been approved, it is still in the interest of the CLT to ensure that it was constructed properly and in compliance with all applicable laws and regulations. Improperly constructed improvements can cause a safety hazard for the occupants, as well as damage the integrity of the structure. This is of particular concern for do-it-yourself improvements, where quality of construction can be highly variable.

**Model Ground Lease.** In Section 7.3, the model ground lease requires the homeowner to submit architectural drawings and a list of materials, as well as copies of all necessary building permits. Section 4.6 of the model ground lease gives the CLT the right to inspect (with 24 hours' notice) the interior of the home once it has received an intent-to-sell notice (described in Section 10.4) prior to the sale of the home.

**Considerations in Design.** Where improvements have been made, it may be good practice for the CLT to conduct a walk-through inspection at the time of resale, to confirm that the improvements were indeed constructed as per plan, in a professional manner, and have been well-maintained. In the event that improvements were not constructed and maintained properly, the CLT could require the homeowner to address all needed issues prior to resale, or in the alternative reduce the resale price by the amount necessary to correct the issues.

# RELATED ISSUES

## Measures to Ensure Proper Maintenance

Maintenance and repairs are of critical importance in protecting the durability of any home. These are measures that do not increase utility, but rather serve to preserve the existing utility of the home. Even with market-rate housing, there is not an expectation of return on investment for maintenance and repairs; instead, the focus is on avoiding a loss in value through a failure to take proper care of the home.

The one major area of difference for CLTs is that CLT homeowners may have fewer means to pay for the cost of maintenance and repairs as compared to more affluent owners of market-rate homes. This is partially addressed by building durable homes in the first place, to lessen the maintenance burden and delay needed repairs. But inevitably, repairs will be needed, and with that, a source of funding to cover their cost.

With market-rate buyers, home equity lines of credit may serve as ready sources of capital to cover these measures. But many CLT homeowners may not be able to access home equity loans due to restrictions imposed by subsidy providers — or simply because they do not have sufficient equity in the home to leverage a line of credit.

As such, many CLTs have looked to strategies to help cover the cost of maintenance and repairs, whether it is through creating repair reserve funds (in turn funded by a monthly fee charged to the homeowner), seeking additional subsidy funding, or in some cases allowing for credit at the time of resale to cover the cost of "big ticket" items (such as a roof replacement).

**Incentive, Penalty, and Hybrid Approaches.** Because resale formulas often fail to incentivize proper building maintenance — or conversely, fail to penalize poor maintenance practices — CLTs should consider measures to ensure that CLT homes are properly maintained in order to serve multiple generations of residents.

- **Incentive-based approaches:** This incorporates a list-based approach, where selected maintenance, repair, and replacement items are incorporated alongside incentivized improvements.
- **Penalty-based approaches:** These approaches come into play at the time of resale, where the CLT inspects the property and identifies items in need of repair. The CLT can choose to require that the seller makes the required repairs prior to resale, or in the alternative, that the cost of repairs is deducted from the resale price in order to allow the new purchaser to cover the cost of needed repairs.
- **Hybrid approaches:** This would incorporate a list-based approach for certain items (such as roof replacements), along with a final inspection prior to resale, where a penalty may be invoked if the home is not in good repair.

*All these issues warrant a much more in-depth discussion, which is beyond the scope of this guide.*

# Multifamily Housing Considerations

As mentioned in the introduction, this guide is focused on single-family ownership housing. But increasingly, CLTs are involved in the development of multifamily forms of housing, which are not addressed specifically in this guide. Fortunately, the proper care and feeding of buildings is baked into multifamily ownership housing.

**Condominiums:** For condominiums, the repair and maintenance of all areas outside of the individual condominium unit is the responsibility of the condominium association, with the unit owner responsible only for what lies within their individual living space. Improvements to the "common areas" are approved and financed by the condominium association itself. Improvements to the individual's condominium unit generally do not require approval as long as (a) they do not involve structural modifications, and (b) do not impinge upon common elements of the building. The most common improvements to the interior of a condominium unit will likely be bathroom and kitchen renovations, which may or may not qualify for a capital improvements credit, depending on whether a CLT believes such modifications improve the utility of the condominium unit. Modifications to enhance the physical accessibility of the unit should be considered utility-enhancing modifications, and therefore receive a capital improvements credit.

**Housing Cooperatives.** A similar rationale to condominiums should apply in the context of full-equity housing cooperatives; however, those are quite rare in a CLT context. A more typical form of cooperative will be the limited-equity housing cooperative, where limitations on share prices may preclude credit for capital improvements – or provide for much less generous credit than would be possible in a full-equity setting.

*Just as in the section above on maintenance, issues relating to multifamily housing warrant a more in-depth discussion, which is beyond the scope of this guide.*

# APPENDIX

## Links

### Sample Policies

- Champlain Housing Trust: Shared Equity Program Capital Improvement Credit Policy
- Community Justice Land Trust Capital Improvements Policy
- Homestead Community Land Trust: Capital Improvements Policy and Process
- Interboro Community Land Trust: Major Alterations Policy

### Referenced Publications

- ***The CLT Technical Manual (2011)***
  - Chapter 11A: The 2011 CLT Network Model Ground Lease
  - Chapter 12: Resale Formula Design
- ***Shared Equity Homeownership (2006)***
  - Chapter 3: Design - Contractual Controls Over Use and Resale

## Summaries of Selected Policies

These four policies were selected to illustrate the range of possibilities for crafting a capital improvements policy. They do not comprise an exhaustive list of capital improvement policies – nor do we claim that they are being proposed as the best possible approaches to developing these types of policies. But they do provide useful examples to draw from in crafting your own CLT's capital improvement policies.

Champlain Housing Trust takes an individualized approach. Homestead Community Land Trust takes a schedule-based approach and Interboro Community Land Trust's policy builds upon Homestead's. Finally, Community Justice Land Trust's approach blends elements of individualized and schedule-based approaches.

### Champlain Housing Trust

Champlain Housing Trust (CHT), based in Burlington, VT, is the largest CLT in the mainland US, with 636 owner-occupied homes in its portfolio. It adopted its current capital improvements credit (CIC) policy in 2017. This policy leans heavily on individual assessments by CHT staff members, with an appraised-based valuation at resale. Key elements of its policy are summarized as follows:

- **What is an eligible improvement?** Improvements are defined as "work done to the home that increases the market value of the home and is above and beyond general maintenance or replacement of existing items of a home." To illustrate, the CIC describes what is — and is not — a capital improvement:

    - *Is a capital improvement:* Replacing carpet with hardwood floors, adding a garage, finishing the basement, completely remodeling a kitchen, adding a fireplace, putting on a deck, adding a bathroom or bedroom.
    - *Is not a capital improvement:* Replacing carpet with carpet, replacing a garage door, new paint, replacing appliances, replacing or repairing a heating system, replacing windows or a roof, replacing wiring or plumbing.
- **Required notifications.** Prior to undertaking construction, the homeowner must first speak to a CHT staff member. The credit amount will be determined by the appraiser at time of resale. The goals of the notification process are two-fold:
    - Minimize the likelihood that improvements are made that will limit the pool of available purchasers
    - Minimize the likelihood that improvements are made that make the home unaffordable to future purchasers.
- **Procedure for receiving CIC.** At the time of resale, the owner who made the improvements will provide the appraiser with a listing of improvements made during this ownership. The appraiser will in turn determine the increase in value attributable to those improvements.
- **Limitations on the amount of CIC.** The actual amount of CIC allowed by CHT may be reduced in order to keep the home affordable to the next purchaser. The homeowner can appeal the decision to a board committee for review, whose decision is final.
- **Calculation of the CIC.**
    - If the overall value of the home has depreciated during the period of ownership, no CIC will be provided.
    - If the overall value of the home has appreciated, the CIC will be the lesser of:
        - Market value added by the capital improvements as stated in the appraisal, or
        - The increase in value of the home, or
        - The maximum CIC as determined by CHT staff.

## Community Justice Land Trust

The Community Justice Land Trust (CJLT), a program of the Women's Community Revitalization Project in Philadelphia, PA, has 36 rent-to-own townhomes in its portfolio, with another 69 townhomes planned for future development. CJLT takes the approach of modifying selected sections of Article 7 in the model ground lease to address capital improvements, as well as creating policy to define eligible improvements. Key elements of its policy are summarized as follows:

- **Modifications to section 7.3**: Section 7.3 is amended to clarify that it covers post-purchase improvements requiring a building permit. It is further amended to include the reasons for withholding consent for a proposed improvement, which include but are not limited to the following: (a) compromising affordability to future buyers, (b) undermining the homes durability, livability, or structural integrity, or (c) creating unsafe conditions on the lease land or the home.
- **Creation of a new section 7.4:** This adds new language describing credit for post-purchase construction completed in compliance with section 7.3, which sets an upper

limit on the maximum credit that a homeowner may earn, in order to keep the home affordable to low-to-moderate income homeowners.
- **Policy describing eligible improvements:** The CJLT advisory committee established three types of capital improvements which should be included on the list of eligible improvements: (1) adding a bedroom, (2) improving energy efficiency and reducing costs to heat a home, and (3) improvements that increase physical accessibility.

## Homestead Community Land Trust

Homestead CLT, based in Seattle, WA, has over 200 owner-occupied homes in its portfolio. It adopted its current capital improvements credit (CIC) policy in 2016. Homestead uses a schedule-based approach to capital improvements, which also includes selected replacement items that might otherwise be categorized under "maintenance." Key elements of its policy are summarized as follows:

- **Goals of the CIC policy:** First, it is to encourage member homeowners to undertake significant improvements to their property by raising the formula resale price by the amount of the credit. Second, it is to ensure that its policy is easily understandable and fairly administered. Third, it is to strike a balance between ensuring future affordability while allowing homeowners freedoms similar to conventional homeowners.
- **Construction and alteration:** For any post-purchase construction requiring the issuance of a building permit, the homeowner must provide the CLT with a copy of architectural drawings, and cannot begin construction until the plans are approved by the CLT's executive director. Upon completion of the work, CLT staff will inspect the property and all construction permits, and make a recommendation to the executive director to either approve or deny the credit. No credits will be provided for any improvements made that fail to comply with this procedure.
- **Definition of capital improvements.** This is defined as a permanent improvement to the property made during the homeowner's ownership of the property for which the homeowner will receive credit at resale if: the permanent improvement is one in which the improvement:
    - The improvement increases the utility of the gross built interior living space, and
    - The improvement has been made with all required permits and approvals, and
    - The executive director and the homeowner sign the Capital Improvement and System Replacement/Upgrade Credit Agreement.
- **Definition of capital system replacement upgrade:** This is defined as a replacement (or upgrade for safety or energy efficiency) of a major capital system listed in the credit schedule valued at over $1,000 made during the homeowner's ownership of the property which:
    - Has been made with all required permits and approvals,
    - Is the subject of a signed Capital Improvement and System Replacement/Upgrade Credit Agreement, and
    - Has a value of $1,000 or more.
- **Why capital systems replacements are incentivized.** This credit is intended to incentivize investments that increase the home's safety, efficiency, and durability. This

includes a Weather Seal Maintenance Credit for replacement of a weather sealing system within the first 3 years of ownership.

- **Affordability gap.** Credits will be given only to the extent that they do not cause the home to become unaffordable to future purchasers.
    - Where 100% credit would render the home unaffordable to income eligible purchasers, then the credit will be reduced to the point where the target affordability is achieved.
    - The maximum affordable sale price is one where the monthly housing costs of the purchaser should not exceed 33% of the gross income for households (adjusted for family size) at 75% area median income (AMI).
- **Credit schedule.** The credit schedule provides a listing of eligible types of capital improvements, capital system upgrades, and weather seal system maintenance -- along with an individualized depreciation schedule for each item. 100% credit is given to each item -- subject both to depreciation as well as the overall affordability cap.

## Interboro Community Land Trust

Interboro Community Land Trust is a new effort based in New York City, which is a partnership between the Center for NYC Neighborhoods, Habitat for Humanity, Mutual Housing Association of NY, and Urban Homesteading Assistance Board (UHAB). Unlike the other two referenced CLTs, they do not, as of yet, have a sizable number of owner-occupied homes in their portfolio. Their Major Alterations Policy was adopted in 2021. Interboro uses a schedule-based approach to capital improvements, which also includes selected replacement items that might otherwise be categorized under "maintenance."

Key elements of its policy are summarized as follows:

- **Goals.** The CLT seeks to balance maintaining long-term affordability with rewarding homeowner investments by granting credit for a portion of the value of certain approved capital improvements.
- **Minor alterations.** These are defined in the ground lease, and require no approval from the CLT.
- **Major alterations.** All major alterations require approval prior to the commencement of work, to ensure that work does not endanger (a) structural integrity, and (b) future affordability. Major alterations are defined as follows:
    - Work that requires a change to the Certificate of Occupancy (for change in use, egress or type of occupancy), or
    - Work that will cost more than $2,500, or
    - Structural changes that increase a property's footprint, property's height, or livable square footage.
- **Restoration at resale:** The CLT reserves the right to deduct restoration costs for improperly constructed improvements at the time of resale.
- **Credit schedule.** The schedule provides a listing of qualified capital improvements. It provides an individualized depreciation schedule, with a small number of items having no depreciation at all (such as increased living space).
- **Required paperwork.** To receive a credit, homeowners must submit an application form, a description of work to be done, a rationale for the work, photos of the areas

where work will be performed, and photos of work already performed (where applicable). CLT staff will respond to applications within two weeks with approval or denial. Upon initial approval, homeowners must solicit a minimum of three bids for the CLT's review, along with any required application materials prepared for the relevant municipal authority having jurisdiction over construction -- at which point final approval will be granted. Where approval is denied, there will be an opportunity to resubmit with changes made at the request of CLT staff.

- **Assignment of credit.** Credit will be assigned upon receipt of itemized documentation for the cost of completed work, along with copies of two other bids received for the work. The CLT aims to respond within 30 days of receipt of these materials.
- **Actual credit received at resale.** Credits for qualified capital improvements will be incorporated into the purchase option price at the time of resale. The amount of credit incorporated into the resale price will be discounted in order to keep the overall pricing affordable to the target income range of buyers: (a) 50% of approved credits will be applied where the home was initially priced to be affordable to buyers below 80% AMI, or (b) 40% of approved credits will be applied where the home was initially priced to be affordable to buyers at or above 80% AMI.