maddin hauser
Maddin Hauser Wartell Roth & Heller PC
attorneys and counselors

Real e-State

January 2008
Vol. 5 Issue 1

An electronic newsletter for real estate professionals

From the desk of:

The Real e-ditor

Today marks the beginning of our fifth year publishing Real e-State. Thinking back over the past five years, our economy here in Southeast Michigan has been … rough. But we've survived and many of us in fact have prospered, despite locally adverse business conditions.

Over that same period of time, while we complained about our one-State recession, other states have suffered calamities of a much more devastating variety: earthquakes and mudslides in California; hurricanes in the deep South; devastating floods in the upper Mississippi Valley, and equally devastating droughts in Georgia; forest fires in Florida, Southern California and elsewhere. And of course, the atrocities committed in New York and Washington D.C. by terrorists on September 11th.

Each time the nightly news focuses on the devastation in some other state I think to myself: with our state's relatively moderate climate, remarkable beauty and being literally surrounded by the largest fresh water source in the world (not to mention thousands of inland lakes, ponds and streams), why aren't businesses and jobs flocking to Michigan, instead of leaving in droves?

Obviously the answer to that question is complex; perhaps even politically charged. But I truly believe, especially now that the rest of the country may finally be joining our little one-State recession, that when Michigan's economic situation corrects (and, of course, it will correct), we may in fact be heading for a boom economy. Why? Because Michigan is not a prime target for terrorists; neither is it susceptible to hurricanes, earthquakes, mudslides, forest fires, droughts and assorted other natural disasters. I also firmly believe that, eventually, water -- fresh, clean water -- will become even more precious than oil. When desert cities run out of fresh water to support their populations, people will return to Michigan in numbers even greater than originally left.

For now, however, the perception is that Michigan is in the doldrums, and the fairways and putting greens in Arizona are green. So let's all help our economy towards recovery. Let's emphasize the good things about Michigan: our water, our moderate climate, our natural beauty, and yes a skilled and hungry (and likely to get hungrier in 2008?) workforce. We're open for business. We've been open for business. Let's not wait for our political leaders to make it happen (we'll all grow old!); it's up to each of us to emphasize why doing business in Michigan makes sense now and for the future. Get in now, while prices are low!

Steven D. Sallen
Editor-in-Chief

Does a Proven Bad Idea Get Better in a Commercial Mortgage Context?

By: Danielle M. Spehar

Unless you have been stranded on a desert island for the last two years, you have been bombarded with news about the current subprime "mortgage crisis." Most people, however, believe the crisis is limited to the single family housing mortgage arena. The image driven into our minds by recent news reports is the family of four that is out on the street because their home was foreclosed.

There are many different kinds of subprime mortgages, including:

- interest-only mortgages, which allow borrowers to pay only interest for a period of time (typically 5–10 years);
- "pick a payment" loans, for which borrowers choose their monthly payment (full payment, interest only, or a minimum payment which may be lower than the payment required to reduce the balance of the loan); and,
- initial fixed rate mortgages that quickly convert to adjustable rate mortgages ("ARM").

Industry analysts report this last class of mortgages has grown particularly popular among subprime lenders since the 1990s. Common lending vehicles within this group include the "2-28 loan", which offers a low initial

See **SUBPRIME** Page 2

Successful Management of Lease Termination Negotioans from Lemons to Lemonaid

By: Steven D. Sallen

"It's been a wild ride this year in retail real estate." So began Co-Star's January 2, 2008 on-line Article titled: *Year-End Close Out: 2007's Top Stories in Retail Real Estate.* Reading through Co-Star's compendium of major news stories throughout 2007, I was struck by two apparent trends: On the mall-owner side, there seemed to be dozens of major mergers, portfolio acquisitions and joint venture deals struck by some of the country's largest retail real estate players. On the tenant/retailer side of things, however, major and familiar store and restaurant chains closed thousands of stores and in some cases closed up business altogether. This national outlook refutes the idea that Michigan is "ground zero" for this kind of thing.

Being a bit of a "wordsmith", I was also struck by some of the euphemisms used to describe these major store closings and related transactions.

- "Foot Locker Closing 250 Stores, Exploring *Strategic Alternatives*."
- "DJM announced the successful completion of the Discovery Store *disposition project* in November, …"
- "CompUSA … finally gave up via an *acquisition by liquidation* …" (all emphasis added)

> **"To manage a successful lease termination negotiation, accurate information is key."**

My own experience in 2007 included store closing and lease buy-out negotiations with some of the tenants and lease

See **BUYOUT** Page 3

PLANNING FOR THE FUTURE: ARE DOWER RIGHTS IN JEOPARDY IN THE STATE OF MICHIGAN?

BY: KASTURI BAGCHI

Michigan has long recognized common law "dower" rights by codifying a widow's right to take one-third of the real property owned by her husband at any time during the marriage instead of taking under her husband's will. *See* MCL§700.2202(2)(c) and MCL§558.1. However, recently in *In re Estate of James W. Miltenberger, deceased*, case no. 133847 (MICH December 13, 2007) the Michigan Supreme Court has agreed to review the constitutionality of the dower election provided for by statute.

In relevant part, James Miltenberger (the "Decedent") was survived by a wife, Sharon Miltenberger (the "Petitioner"), and a daughter from a prior marriage, Sandra Swartz (the "Respondent"). The Decedent's will left nothing to the Petitioner who then sought to exercise her statutory dower rights pursuant to §2202(2)(c) and take one-third of the Decedent's estate. Because §558.1 applies only to widows and not widowers, the Respondent challenged the Petitioner's election in probate court on the grounds that the dower statute violated the equal protection clauses of both the state and federal constitutions. The probate court flatly rejected the constitutionality claims of the Respondent on the grounds that the Michigan Legislature has the authority to deem the protection of widows as an important government objective and that "dower is substantially related to the achievement of that particular objective…"

The probate court's ruling was subsequently upheld by the Michigan Court of Appeals on March 27, 2007. The Court of Appeals closely followed the analysis of *Kahn v. Shevin,* 416 U.S. 351 (1974), in which the United States Supreme Court upheld the constitutionality of a statute entitling financial benefits to widows, but not to widowers. Like the *Kahn* Court, the Michigan Court of Appeals found that state "legislatures have a legitimate interest in protecting the economic interests of widows and protecting them from becoming impoverished"; thus, dower statutes can be upheld if they are "reasonably designed to further" such a state policy. In considering whether the Michigan dower statute is so "reasonably designed", the Court of Appeals turned to another decision made by the United States Supreme Court in *Orr v. Orr*, 440 U.S. 268 (1979). In *Orr*, the Supreme Court struck down as unconstitutional Alabama statutes which forced husbands, but not wives, to pay alimony upon divorce. While the *Orr* Court recognized the legitimacy of the statutory objective to reduce "the economic disparity between men and women", the statute itself "was not substantially related to achieving those objectives because in divorce actions…the court holds an individualized hearing to consider the parties 'relative financial circumstances.' Therefore, there was no reason to use sex as a proxy for need or to assume that due to economic disparities, women require financial assistance whereas men do not." Unlike divorce cases, the Michigan Court of Appeals noted that the rights of spouses in estate matters are settled without any individualized hearing by operation of law or "'prior decisions of the decedent….So…if women are to be 'compensated' through the probate courts, there must be some equivalent of dower for them'….[I]f an alternative to dower exists that is more desirable as a matter of policy, the Legislature, not the judiciary, must so decide." [*quoting Boan v. Watson,* 282 SC 516, at 520-21(SC 1984)]. Consequently, the Michigan Court of Appeals limited the application of the *Orr* ruling to alimony disputes only.

In April of 2008, the Michigan Supreme Court will review the Court of Appeals ruling as to the constitutionality of the dower statute. Stay tuned to future issues of Maddin Hauser's Real *e*-State newsletter to see if the Michigan Supreme Court will limit the applicability of the *Orr* doctrine or expand its scope to specifically strike the Michigan dower statute.

SUBPRIME (Continued from Page 1)

interest rate that stays fixed for two years after which the loan resets to a higher adjustable rate for the remaining life of the loan, in this case 28 years. The new interest rate is typically set at some margin over an index, for example, 5% over a 12-month LIBOR.

According to Chairman Ben S. Bernanke of the Board of Governors of the Federal Reserve System in his speech to the Economic Club of New York on October 15, 2007, 16% of subprime loans with ARMs were 90-days into default or in foreclosure proceedings, roughly triple the rate of 2005. The Mortgage Bankers Association has reported that subprime ARMs only represent 6.8% of the loans outstanding in the US, yet they represent 43.0% of the foreclosures started during the third quarter of 2007.

Despite the risk of foreclosures and defaults pursuant to ARMs in the residential context, in our practice we have actually begun to see similar offerings in certain commercial transactions. For example, a person looking to finance a small apartment complex located in a small outstate community was presented with a loan proposal that contained a 30 year term/30 year amortization (somewhat akin to a residential mortgage), an interest rate which is locked for 60 months (5 years) then the rate is subject to change semi-annually based upon a 12-Month Treasury Average; and a floor interest rate of 7.983% with a ceiling of just under 14%. The Monthly Treasury Average was described as the 12-month average of the monthly average yields of U.S. Treasury securities adjusted to a constant maturity of one year. It is calculated by averaging the previous 12 monthly values of the 1-Year CMT.

While ARM products have been available in the commercial context for some time, the key differences are the loan term has typically been limited to ten years and the borrower is often permitted to either refix the interest rate or switch to a floating rate, which enabled them to protect against market instability if they elected.

Proponents of subprime lending maintain that the practice extends credit to people who would otherwise not have access to the credit market. Carrying this logic one step further, subprime lending in the commercial context affords someone that might not otherwise be able to secure traditional financing for an entry project an opportunity to capitalize on the current suppressed market prices. While it appears unlikely that there will be a proliferation of these types of products in the commercial real estate arena, what remains to be seen is whether the crisis in the single family housing arena is foreshadowing what may occur in the commercial real estate transactions.

BUYOUT (Continued from Page 1)

"disposition" firms mentioned by CoStar. While every store closing presents its own unique challenges to the property owner, if handled properly (and with a little luck) they can also present *new opportunities* for the owner. For example, in one case we successfully negotiated a significant lump sum lease buyout payment that was almost four times greater than the disposition firm's opening offer; then within four months we found a new tenant to take over the space at a lease rate which was only slightly less than the original tenant had been paying. The economics for the owner turned out to be the proverbial "home run", as the lease buyout payment far exceeded the sum of the cost to carry the space for the interim months plus the rental difference over the term of the new lease.

Lease buyout negotiations are best handled from a position of power and, in the case of retail store closings, knowledge is power to the owner. To manage a successful lease termination negotiation, accurate information is key. Answers to these and other questions are crucial to success: Is the tenant closing some or all of its stores? Who is handling the disposition process for the tenant, and what is their track-record or *raison d'ĕtre*? What is the tenant's (or any lease guarantor's) general financial condition? What is the market value of the remaining lease term, and what are the short and long term prospects for the tenant to sublease or for the owner to lease the space? What are the owner's lender's rights in regards to any lease termination, and must they give their approval? Would any buyout payment have to be used to pay down the mortgage and, if so, will a prepayment penalty apply? Is a tenant bankruptcy threatened or otherwise a possibility?

Conveniently, much of the information an owner needs to make informed decisions and negotiate from a position of strength is available on the internet, especially where the tenant is a nationally branded name. For example, publicly traded companies file SEC documents; these may explain the scope and purpose behind closing a block of stores, while also laying out the company's (or its parent's) overall financial condition.

Another client chose a high-risk strategy to resolve a major tenant office building vacancy. When the tenant gave notice that it would vacate its Class A office space three years early to consolidate operations out of state, the owner advised the tenant to direct its subleasing efforts towards multiple smaller subtenants. The tenant, however, only tried to re-fill the entire space with a similar "big" tenant, turning its back on several small tenant opportunities. Its efforts to refill the space with one user were fruitless, as the local market was saturated with similar large blocks of premium office space. The owner worried that after three years, it would get back possession of the vacant space, just months before maturity of its mortgage. But the owner knew that the key to re-leasing the space was to divide up the space into smaller tenant units, and to seek out 1,000 to 5,000 square foot users. Confident of his prospects for re-leasing smaller units, the owner formed a subsidiary company and negotiated a favorable sublease with the tenant. Now, the owner (through its affiliate) is sub-subleasing incremental spaces to smaller (and more lucrative) tenants. The goal is to be 100% occupied by loan maturity, and then refinance the building. Will this high stakes gamble payoff? Only time will tell, but early sub-subleasing efforts have been promising, and generating leasing activity where the tenant had no success with its own efforts to sublease the entire space.

2008 is likely to be much like 2007 for our local real estate market. More tenants will be looking to give back property to owners. But with a little knowledge, some creative planning and a bit of luck, even these lemons can be squeezed into lemonade.

Save the Date

Maddin, Hauser, Wartell, Roth & Heller, P.C.
presents its

15th Annual Real Property Symposium

to be held

Wednesday, March 12, 2008

At the Glen Oaks Country Club
from 8:30 a.m.—11:00 a.m.

Further details about the program and an invitation will follow in the coming weeks.
For more information please call or e-mail
George A. Contis, Esq. at (248) 827-1886 or gac@maddinhauser.com,
Danielle M. Spehar, Esq. at (248) 827-1892 or dxs@maddinhauser.com, or
Kasturi Bagchi, Esq. at (248) 359-7501 or kxb@maddinhauser.com.

maddin hauser
Maddin Hauser Wartell Roth & Heller PC
attorneys and counselors

www.maddinhauser.com
28400 Northwestern Highway
Third Floor, Essex Centre
Southfield, Michigan 48034
Phone: 248-827-1861
Fax: 248-359-6161

The Real e-State Staff:

The will to win is important, but the will to prepare is vital.

Joe Paterno, football coach

Court of Appeals Protects Joint Tenants' Right to Avoid Uncapping of Taxes

By: Lindsay A. Jerabek

As you may recall from a previous Maddin Hauser Real *e*-State issue, the Michigan Constitution was amended in 1994 to limit the amount that the "taxable value" of a parcel of real property may increase each year, *so long as the same party owns the property*. Codified in the General Property Tax Act, M.C.L. § 211.1, *et seq*. (the "Act"), the Act provides that "[u]pon a *transfer of ownership* of property after 1994, the property's taxable value for the calendar year following the year of the transfer is the property's state equalized valuation for the calendar year following the transfer." (emphasis added). Sections 27a(6) and 27a(7) of the Act describe conveyances that will and will not constitute a "transfer of ownership". Section 27a(7)(h) provides one such exemption involving the creation or termination of a joint tenancy.

Despite the explicit language in the Act, in *Moshier v. Whitewater Township*, No. 272617 (Mich. App. December 20, 2007), the Michigan Tax Tribunal upheld Whitewater Township's decision to uncap real property taxes in a transaction which ultimately terminated a joint tenancy. On appeal, the Michigan Court of Appeals found that the Tribunal "impermissibly graft[ed] onto the statute a requirement not contemplated by the statute's plain and unambiguous language."

In the *Moshier* case, Moshier's parents owned certain real property (the "Property") and subsequently granted a quit claim deed to the Property to themselves and Moshier as joint tenants with rights of survivorship. After Moshier's father passed away, Moshier's mother quit claimed her entire interest in the Property to Moshier, thereby terminating the joint tenancy. Whitewater Township found the conveyance from Moshier's mother to Moshier to be a "transfer of ownership" under the Act and notified Moshier that the Property's taxable value would be uncapped and reassessed upon the upcoming tax year.

Moshier appealed the Township's decision to the Michigan Tax Tribunal, arguing that the conveyance fell under § 27a(7)(h) and was therefore exempt. Section 27a(7)(h) provides that a transfer between two or more persons that creates or terminates a joint tenancy will not constitute a "transfer of ownership" within the meaning of the Act if:

1. at least 1 of the persons involved in the transfer was an original owner of the property before the joint tenancy was initially created and, if the property was held as a joint tenancy at the time of the transfer,
2. "*at least 1 of the persons*" involved in the transfer was a joint tenant at the time the joint tenancy was initially created and that person has remained a joint tenant since the joint tenancy was created.

The Tax Tribunal conceded that the first requirement was met because Moshier's mother was an original owner of the Property. However, the Tribunal ruled that Moshier failed to meet the second requirement because he did not "possess an ownership interest in the property prior to creation of the joint tenancy." Moshier appealed the Tax Tribunal's decision to the Michigan Court of Appeals.

With regard to the second requirement, the Court of Appeals found that the Tax Tribunal ignored the language of § 27a(7)(h) which expressly requires only that one of the persons involved in the transfer was a joint tenant at the time the joint tenancy was originally created, and that this person remained a joint tenancy since that time. The Court held that because Moshier and his mother were both joint tenants at the time the joint tenant was created, the transfer also meets the second requirement under § 27a(7)(h) and thus the exemption applies.

Not only does Michigan law shelter real property owners from steep increases in property taxes each year, but it also carves out exemptions from the uncapping of taxes upon certain conveyances which are not deemed as "transfers of ownership" by operation of law. Taking advantage of these uncapping exemptions is an important cost-saving mechanism when structuring your acquisition or sale during this tough economic time. The good news is that the Court of Appeals also seems to recognize the value of these exemptions and has struck down a local ruling which sought to limit the scope of the exemption. Contact your Maddin Hauser attorney for additional information on the General Property Tax Act and its application to your acquisition or sale.