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From the desk of:

The Real e-ditor
By: Steven D. Sallen

New IRS Rules for Lenders May Help Troubled Commercial Borrowers

From about the late 1990's until last year, securitized loans were all the rage for financing commercial investment real estate. These securitized loans were issued by lenders known as Real Estate Mortgage Investment Conduits (REMIC). They offered low interest rates, high loan-to-value ratios, long amortization schedules, seven to ten year maturities, and non-recourse terms, which made securitized loans the ideal financing vehicle for real estate. This, in spite of the fact that the loan originators were often inflexible in their loan terms, and expensive in loan underwriting, documentation and fees.

But as the economy ground to a halt late last year, the hidden face of the REMIC loan began to assert itself: The "loan servicers" were unwilling – indeed incapable – of responding to the issues, problems and special needs of its borrowers. Borrowers who were accustomed to "relationship banking" found themselves hamstrung by the faceless bureaucracy of the loan servicer.

> *"This Revenue Procedure provides new tax guidance that will allow pre-default modifications of loans held by REMIC's or investment trusts, without adverse tax consequences … even if the foreseeable default is 'more than one year in the future'."*

Indeed, absent an "imminent loan default," loan servicers have refused to entertain any discussions concerning loan modifications, in some cases due to fear that such modifications could cause the IRS to challenge the tax status of certain securitization vehicles that hold such loans in securitization pools. In fact, REMIC paralysis appeared to stem in large part from IRS rules which imposed a tax of 100% of net income derived from "prohibited transactions." Since modification or other "disposition" of a qualified mortgage could be deemed a prohibited transaction, the tax consequences of amending a Commercial Mortgage Backed Securities (CMBS) loan could be disastrous to the note holder and its entire CMBS pool of loans. Until now, the only way borrowers could get a servicer to discuss their situation was to default!

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Much Ado About Nada … The Reality of Michigan's New Foreclosure Statute

By: Courtney D. Roschek and Martin S. Frenkel

On May 20, 2009 Governor Granholm signed into law, amendments to Michigan's foreclosure by advertisement statute, effective July 5, 2009 (MCL 600.3204 & 3205). The amendments were a response to the tidal wave of foreclosures hitting Michigan and are an effort to "break" that wave by slowing down the foreclosure process.

In short, the lenders must engage in a 90-day pre-foreclosure "process" to attempt to avoid foreclosure. The process begins with the lender's issuance of a written notice to the borrower informing the borrower of his rights, and the opportunity to avoid foreclosure. If the borrower responds within applicable time periods, the parties are to meet and determine whether a modification option is viable. If the parties cannot agree, the Act requires a calculation of the borrower's eligibility for a government foreclosure assistance program.

While the sheer volume of changes is substantial, and the reaction of the lending industry initially reflected concern for the new procedures, the *reality* behind the amendments is a *de minimus* effect on the lending industry. Here's why:

The Act affects only a limited category of properties. The new law only applies to residential property that a borrower claims *as his principal residence* exempt from taxes under MCL 211.7. Thus, commercial properties, and non-homestead residential properties are excluded.

The Act only helps borrowers who help themselves. After the holder/servicer of the mortgage issues the newly required written notice (advising the borrower of his rights, containing information about the default, and identifying a designated contact), the borrower has only 14 days to respond to the notice by contacting the designee or an approved housing counselor. No response? The holder/servicer can proceed with foreclosure by advertisement so long as the designee is not contacted by an approved housing counselor within 10 days of the 14-day response deadline. Additionally, if the designee, in good faith, offers the borrower a loan modification and the borrower does not execute and return the modification agreement to the designee within 14 days, the holder/servicer may proceed with foreclosure by advertisement.

The Act is temporary. The 90-day pre-foreclosure process only applies when the first notice of foreclosure by advertisement is published after July 5, 2009 and before July 5, 2011.

The Act requires borrowers to qualify for a modification. If the parties are unable to come to a modification agreement, the Act requires the holder/servicer to calculate whether the borrower is eligible for a modification at all; the Act provides for a guided calculation proscribed by the FDIC. If the borrower is not eligible (which will be common) the holder/mortgagee may proceed with foreclosure by advertisement. Thus, the Act only requires judicial foreclosure when the borrower is eligible for a modification, and the holder/servicer chooses not to extend it.

In summary, while the new law presents new hurdles to Michigan's traditionally fast track foreclosure by advertisement process, these hurdles are of little import except to lenders and mortgagees engaging in foreclosures of homestead residential properties. And even in those circumstances, such lenders and servicers may "test the waters" by serving the new notice required by the amendment. If the borrower fails to timely respond to the notice, foreclosure by advertisement may proceed as normal. If the borrower does timely respond, and qualifies for a loan modification, but the lender/servicer still wishes to foreclose, then judicial foreclosure remains an option – albeit a lengthier and more costly one.

THE OPPORTUNITY OF TIMING

SECOND IN A SPECIAL SERIES

BY: GEORGE V. CASSAR, JR.

Last quarter I wrote on the ***Timing of Opportunities*** and how depressed asset values in our current economy may make current transfers of real estate to the next generation a tremendous strategy for income, estate and gift tax planning. We discussed some tools for making such gifts that included the use of documents such as Grantor Retained Annuity Trusts (GRATs), Charitable Remainder Annuity Trusts (CRATs), Self Cancelling Installment Notes (SCINs), Intentionally Defective Grantor Trusts (IDGTs) and Qualified Personal Residence Trusts (QPRTs). The QPRTs specifically deal with the transfer of your personal residence or vacation home in a way that shifts all of the future appreciation on that property, and, consequently, future estate tax liability on that appreciation, out of your estate for estate tax purposes.

Now, as a follow up I'm writing to report that while these techniques remain valuable strategies, it has never been more important to ensure that they are properly implemented and administered. In an environment where every individual or business is looking to save costs and maximize profits, the Internal Revenue Service (IRS) is no different.

The IRS Estate and Gift Tax Program recently started working with state and county authorities in several states to determine if real estate transfers reported to them are unreported gifts. These authorities track such real estate transfers through the filing of deeds at the Register of Deeds offices. And in doing so, a "good deed" for transfer purposes may cause "not so good" results for gift tax purposes.

Although a tax may not be due, a gift tax return may be required to be filed for real estate transfers above the annual exclusion amount, which is $13,000 per recipient for 2009. The annual gift tax exclusion amount can be doubled to $26,000 if the gift is treated as being made by both a husband and wife to the same beneficiary, which incidentally in and of itself requires a gift tax return to be filed so as to document the "splitting of the gift."

> ***In an environment where every individual or business is looking to save costs and maximize profits, the Internal Revenue Service (IRS) is no different.***

If you or any of your clients are implementing a gifting strategy that involves real estate, be sure that your attorney and/or your accountant is aware so that the appropriate gift tax return can be filed. Often times an appraisal for the valuation of the gift is advisable and as such, your real estate appraiser should be involved as well. Gift tax returns are due by April 15th of the year following the gift just like regular income tax returns. And don't forget, although a tax may not be due, there may still be a requirement to file a gift tax return. And if taxes were due, penalties can be assessed by the IRS on all delinquent returns filed.

Feel free to contact me or your favorite Maddin Hauser attorney to discuss any questions or concerns you may have in greater detail. We would be happy to speak with your accountant or tax preparer as well.

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George V. Cassar, Jr., Esq.
Has Been Named One of
Michigan's Rising Stars 2009 By:
Super Lawyers

Congratulations George!

INTRODUCING … THE NEW … DNRE

BY: STEVEN D. SALLEN

In 1995, the Michigan Department of Natural Resources was split into two departments: the Department of Natural Resources was tasked with conservation, protection, management, use and enjoyment of the State's natural resources, and the Department of Environmental Quality was tasked with driving improvements in the State's environmental quality for the protection of public health and the State's natural resources. This governmental reorganization was supposed to streamline permitting and enforcement, and result in significant cost-savings efficiencies. Now, however, just 14 years later, that structure has been abandoned in favor of return to a single Department, now to be called the *Department of Natural Resources and Environment* or *DNRE*. This change was announced by Governor Granholm's Executive Order 2009-45, Executive Directive 2009-6, issued on October 8, 2009, which will take effect on January 17, 2010. How this re-shuffling of the environmental deck will affect the regulated community and the environment in Michigan remains to be seen. But with the State severely strapped for cash, one can't help but wonder about the timing of this major reorganization.

Don't Let Unsubstantiated Fears Prevent You From Considering Viable Multi-Family Project Financing Alternatives

By: Danielle M. Spehar

Notwithstanding the nightmare that many have faced due to the continuing weakened state of the economy, or the fears associated with the impending Halloween season, those in the multi-family housing project arena need not worry about the horror stories they have heard about FHA-HUD financing. Much like the ghost stories kids have repeated at sleepovers for countless years, much of the information that has been disseminated about FHA loan programs and the process of obtaining such financing are nothing more than tall tales.

While various programs exist for both new construction, rehabilitation and refinance projects, one of the primary misconceptions is that FHA loan programs apply only to low income housing projects. That just isn't true. Several market rate programs exist for apartment communities. A second common misconception is that financing is available only in communities typically thought of as economically distressed. Several projects utilizing such forms of financing in this year alone are located in communities not typically associated with economic need – Rochester, Farmington Hills, West Bloomfield and Auburn Hills, to name just a few. Two additional concerns, shared by many that are unfamiliar with FHA-HUD programs and processes, are that the paperwork is overwhelming and the programs impose a multitude of restrictions on the rents that can be charged, and the operations of the projects themselves. Having recently completed the process on two market rate, refinance projects, I can attest that the paperwork was no more cumbersome than a securitized loan transaction and, I was pleasantly surprised to learn, the process proceeds with surprising rapidity. In the market rate context, the Regulatory Agreement is relatively straightforward and imposes a reasonable framework for the operation of the project that is not overly burdensome.

The permanent loan programs offer a number of benefits including:

- ✓ Non-Recourse
- ✓ High Leverage
- ✓ 35 year fixed term, fully amortized
- ✓ Favorable interest rates (even factoring in the mortgage insurance premium)
- ✓ Step-down prepayment penalty
- ✓ Fully assumable

The message to those in the multi-family housing arena is this: don't allow your fear of things that go bump in the night prevent you from learning about a potentially viable and attractive source of financing.

Talk to your Maddin Hauser attorney about the available FHA-HUD financing programs, and step-by-step assistance through the process.

* * * *

All of us here at Maddin Hauser Wish You A ...

Happy Halloween!

Maddin Hauser Wartell Roth & Heller, PC Has The Best Lawyers

The *Best Lawyers In America®* is published annually and is based entirely on peer review. In circulation for the last 25 years, the top lawyers around the country have made *Best Lawyers* the leading legal referral publication by candidly evaluating the work of other top lawyers in the same specialties and geographic areas. According to *Crain's Detroit Business*, the annual publication of *Best Lawyers*, is the oldest and most-respected peer-reviewed publication in the legal profession.

Maddin Hauser is proud to congratulate the following exceptional "family" members with a hearty **Job Well Done**!

- ★ Mark R. Hauser
- ★ Harvey R. Heller
- ★ John E. Jacobs
- ★ Charles M. Lax
- ★ Michael W. Maddin
- ★ Richard J. Maddin
- ★ Lowell D. Salesin
- ★ Steven D. Sallen
- ★ Steven M. Wolock

"Gardens are not made by sitting in the shade."

Rudyard Kipling

Michigan Court of Appeals Favors Strict Interpretation of Title Policy Coverages

by: Kasturi Bagchi

Imagine that you have just helped a client purchase a parcel of developed property. Then, imagine getting a call a week later from that client that the municipality demolished the improvements and that the property had been listed for condemnation in the city's records for over a year. Unfortunately, this nightmare became a reality for the plaintiff in *Glenn v. First American Title Insurance Company,* docket number 285669, Michigan Court of Appeals, June 25, 2009.

In *Glenn*, the plaintiff bought a home in the City of Pontiac on or about October 20, 2006. At the closing, plaintiff also paid for an owner's title insurance policy. Plaintiff alleges that soon after she bought the home, and without any notice to her, the City demolished the home. Plaintiff then learned that the home was on the City's condemnation list on file with Building and Safety Department since October 2005, one year before she bought the house.

Plaintiff submitted a claim under the title insurance policy and coverage was denied. Plaintiff then filed a lawsuit against the title company for breach of contract. Plaintiff argued that the claim should have been honored because the notice of condemnation appeared in the public records at the policy date. The policy stated that coverage is excluded for loss to the insured as a result of the government's exercise of its police powers or the existence or violation of any law or regulation; however, such exclusion is inapplicable "if notice of the violation or enforcement appears on Public Records at the Policy Date." Plaintiff claimed that "Public Records" include records beyond those maintained at the register of deeds, and "that the notice of condemnation was a public record since it was on file with the City of Pontiac's condemnation records when the policy was issued." Both the trial court and the Court of Appeals disagreed and found in favor of the title insurance company. The Court of Appeals noted:

> The Policy defines "public records" as "records that give constructive notice of matters affecting Your Title, according to the state statutes where your land is located … Further, in Michigan, the Legislature has determined that the office of the county of the Register of Deeds is the proper place to record documents that give constructive notice of matters affecting title to real property. [*citing MCL 565.25 and 565.29*].

Based on such unambiguous language, the Court of Appeals upheld the trial court's ruling that records of condemnation proceedings are not public records as defined in the policy "as they do not relate to title to the Property and are not filed in the office of the county Register of Deeds." Therefore, the coverage exclusion under the title policy applied.

This case serves as a grim reminder to all property purchasers that title insurance policies are not a substitute for conducting thorough due diligence. In spite of the sympathetic facts before them, the *Glenn* Court looked only to the four corners of the title insurance policy and concluded that a strict interpretation was warranted based on the unambiguous definition of public records contained in the policy. Title policies must be reviewed carefully for coverages and exclusions based on the literal approach adopted by the Court of Appeals.

What can a broker do to mitigate concerns of condemnation? A first step would be to make sure that the seller discloses accurately receipt of any and all notices of any kind. A second step may be to review any appraisal report to see if the report mentions or discloses any pending actions or violations. A third step may be to encourage the buyer as part of the normal course of due diligence to make an inquiry with the municipality as to any pending actions. And then, let the buyer beware.

Mark Your Calendars!

Friday, October 23, 2009

Skyline Club Southfield@ 7:30 a.m.

Steve Sallen will once again be making an informative presentation to the commercial real estate brokerage community on Friday, October 23, 2009 at 7:30 a.m., with a program entitled:
Land Contract or Purchase Money Mortgage? A Thing of the Past … Or the Next Big Thing?

This program, presented in cooperation with First American Title Insurance Co., will cover topics such as: Advantages of seller financing; how to determine if the buyer and property are candidates for seller financing; what are the differences between a land contract and purchase money mortgage, and much more!

Space is extremely limited! For more information, contact Steve Sallen (248) 827-1861

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New IRS Rules for Lenders May Help Troubled Commercial Borrowers

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On September 16, 2009, however, and with retroactive effect to loan modifications made on or after January 1, 2008, the IRS issued Revenue Procedure 2009-45. This Revenue Procedure provides new tax guidance that will allow pre-default modifications of loans held by REMIC's or investment trusts, without adverse tax consequences to the lender, provided that the holder or loan servicer "reasonably believes that there is a significant risk of default of the pre-modification loan upon maturity of the loan or at an earlier date." Such belief may even take into account "credible written factual representations" made by the borrower, even if the foreseeable default is "more than one year in the future."

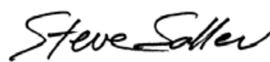
This Revenue Procedure is especially intended to assist borrowers with notes that will balloon in the relatively near future, where the underlying real estate has provided sufficient cash flow to satisfy debt service before maturity, but where sufficient capital to refinance balloon payments is not anticipated to be readily available. This situation is being faced by many borrowers right now, and is only expected to worsen in the very near future as literally thousands of securitized loans come due in the next few years. Estimates are that $300 billion to $500 billion in commercial real estate loans will come due this year, and on average, $400 billion of loans will mature each year over the next decade. A substantial percentage of maturing loans will be REMIC loans.

Loan modifications which may be considered include:

- ✓ interest rate changes;
- ✓ principal forgiveness;
- ✓ extension of maturity;
- ✓ alterations in the timing of interest rate changes; and
- ✓ alterations to principal amortization schedules.

In fact, it is the ability to extend maturity dates that may have the greatest positive effect in reducing the number of foreclosures, as these loans continue to mature into an environment where credit markets remain frozen. However, collateral value will have to be re-tested, and modifications can only proceed if loan-to-value ratios hold up.

Nothing in this new Revenue Procedure requires note holders or loan servicers to cooperate with borrowers, and offer loan modifications. However, the excuse that IRS regulations prohibit them from helping, now is substantially mitigated. Let's hope that note holders and loan servicers will use Revenue Procedure 2009-45 to help their borrowers (and ultimately themselves) avoid the same kind of catastrophe as crippled the economy during the sub-prime residential mortgage crisis last year.



Progress in Motion ...

After being shuttered for 25 years, losing its grand staircase to be cemented over and replaced with an escalator, robbed of copper piping and chandeliers, liquidation of linens, china and nearly anything of value, and then, at a redevelopment cost of approximately $190 million by the Cleveland-based Ferchill Group, the legendary Book Cadillac Hotel reopened one year ago this month.

Legends in their own right, the Book brothers — Herbert, Frank and J. Burgess, Jr. broke ground on the hotel in 1923, but soon lost it in the 1930s during the Great Depression. Frank Capra's 1947 movie *State of the Union*, starring Katharine Hepburn and Spencer Tracy was made there, and this grand hotel hosted many other celebrities, presidents, newsmakers and sports personalities over its vast storied history.

Our own editor-in-chief, Steven D. Sallen, helped assist in one of the many complicated layers of project financing.

Disclaimer: The material contained in this newsletter is not legal advice; you should consult an attorney for legal advice regarding your specific situation.

Nothing herein creates or is intended to create an attorney-client relationship between Maddin Hauser or any attorney employed by Maddin Hauser with any person. To hire an Maddin Hauser attorney, contact us directly.

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