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From the desk of:

The Real e-ditor
By: Steven D. Sallen

HELLO 2010!!

If you're like me, your New Year's Eve celebration four weeks ago was probably more about saying good riddance to 2009, than it was about welcoming the new year. 2009 was a year unlike any in our lifetimes; especially here in southeast Michigan. The bad financial and local political, and even sports news hit us in steep, relentless waves throughout the year. So, goodbye 2009 … *and don't let the door hit you in the backside on the way out!*

But wait! If 2010 is to be any better, we cannot simply look backwards and breath a sigh of relief. No. This is the time, more than ever before, to look forward. To roll up our sleeves, and plan our respective business strategies for 2010. The slate is wiped clean. We have weathered a massive financial storm, and we're still here, and life goes on! Now we have to move beyond wrecked real estate markets and plan for the future.

2010 will be dominated by negotiations between owners and tenants for lease modifications and lower lease rates *[see related story in this issue]*. Predatory landlords (and tenant reps) will be looking to entice healthy tenants to relocate. Property owners will struggle to meet debt service as vacancy rises and lease rates fall. And property owners will search for ways to extend or replace maturing term loans, on account of a lack of available permanent financing options, due to continuing soft credit markets; that is, unless owners are willing to sign personally, and even put in cash.

2010 will also present new deal opportunities for strong buyers. Prices have been *slashed*, and lenders with foreclosed properties will look to get those properties off their books. Undoubtedly, there will be a lot of market activity; the question is: how will *you* take advantage of what the market has to offer in 2010?

Steve Sallen

BARGAINING WITH DISTRESSED LANDLORDS

BY: STEVEN D. SALLEN AND KASTURI BAGCHI

Many property owners have been, and continue to be weakened by the lingering recession. Falling rental values, declining occupancy rates, and maturing loans with no readily available replacement financing are all impacting landlords' bottom lines and eroding their equities. For tenants, this may create a leverage opportunity, especially where they are strong enough, their remaining lease term is short enough, or other circumstances make a tenant's threat to vacate the leased premises, viable. As in 2009, many tenants are expected to demand to renegotiate their existing leases. Here are some points that tenants should consider, and landlords must be prepared to respond to.

Tenants who demand lowered rent should offer something of value in return. Most Landlords will not, and cannot afford to slash rent, with no *quid pro quo*. Most landlords have mortgages to pay, and we all know how grudging lenders are being in offering concessions. There are several areas where tenants can offer something in return. Tenants should be prepared to offer an extension of the lease term in exchange for any rental concessions. It will be far easier for a Landlord to justify a rental reduction in the short term, if the rental stream is contracted to continue beyond the original term. Also, consider escalating the rent over time, perhaps even back to pre-concession levels. Shift responsibility for some or all operating expenses to the tenant. Many Landlords may need the added certainty that operating expenses will not increase; therefore, changing a gross lease to triple net may give a landlord confidence that it won't be damaged on the back-end by operating expense inflation. Tenants can offer a personal or affiliate guaranty, or a so-called good-guy guaranty, where the guaranty is only effective if the tenant defaults and fails to immediately yield possession of the leased premises to the landlord.

For new leases or lease amendments providing for freshening of existing space, the landlord's financial strength may be an issue. Can the landlord afford to pay for the improvements that have been promised? Tenants may need to examine a landlord's financial statements; in the old economy, such financial analysis was always downstream, and almost never upstream to the landlord. Many landlords are mere shell company limited liability companies, whose only asset is the building in question. Add to that, the likelihood that the building's equity is probably eroded, and tenants may have little recourse if the landlord cannot perform the build-out. Alternatively, or additionally depending on the bargaining strength of the parties, a tenant may demand certain protections. For example, that landlord commit tenant improvement dollars in advance by depositing funds in escrow, or obtain a letter of credit naming the tenant as the beneficiary.

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On January 17, 2010, the merger between the Michigan Departments of Natural Resources and Environmental Quality was completed. The new agency is called the Michigan Department of Natural Resources & Environment. For more information, please refer to the article in our October 2009 issue of *Real* e-*State*.

TAX ALERT! ARE YOU EARNING COMPENSATION AS A PARTNERSHIP MANAGER?

BY: GEOFFREY N. TAYLOR

On April 2, 2009, Congressman Sander Levin, a Michigan Democrat and member of the House Ways and Means Committee, introduced tax reform legislation applicable to certain partnership interests, known as "carried interests." This legislation is included in the Tax Extenders Act of 2009 (H.R. 4213). The United States House of Representatives passed H.R. 4213 on December 9, 2009. The United States Senate received H.R. 4213 on December 10, 2009, but has yet to vote on the matter.

The term "carried interest" refers to a share of the profits of a partnership that is paid to the partnership manager as compensation and that is designed to incentivize the manager to maximize partnership profits.

The bill generally treats income with respect to carried interests (other than certain pro rata income allocations attributable to invested capital) as ordinary income rather than capital gain. As a result, this income will be subject to federal income tax at ordinary income tax rates rather than capital gains tax rates, which are lower. This income would be subject to self-employment tax (*i.e.*, treated as a wage). In addition, gain on the disposition of a partnership interest would be taxed as ordinary income rather than capital gain.

The original targets of this tax increase were private equity and hedge fund managers who typically receive a share of the fund's profits in exchange for advisory or managerial services. However, the legislation is very broad in scope and applies to any partnership interest issued by a partnership entity that owns rental or investment real estate to a person who provides substantial advisory services to that partnership. For a real estate partnership, carried interests are often an extensively negotiated component of the venture. By allowing the general partner to share in partnership profits without having to contribute capital, carried interests align with the interests of the general partners and limited partners, while recognizing the entrepreneurial risks the general partner assumes. Accordingly, the legislation would significantly increase the tax burden of certain general partners by changing the character of the income that flows through to them from the partnership.

Supporters of the bill argue that carried interest is essentially a fee for management or investment advisory services and, therefore, it is appropriate to tax it in the same manner that fees for services are usually taxed, *i.e.*, as ordinary income.

Opponents argue that, if the source of carried interest income is earnings on the partnership's investments, it should be treated like any other investment income, *i.e.*, long term capital gain if held for more than a year. Opponents also argue that the bill puts significant additional pressure on an already weak commercial real estate industry which faces mounting delinquencies, foreclosures and a lack of accessible credit.

If the bill is passed, the carried interest tax provisions would take effect for taxable years ending after December 31, 2009; therefore, the proposed rules would take effect on January 1, 2010 for general partners on a calendar tax year. The bill contains no grandfathering or transition provisions; therefore, the rules would apply to carried interest arrangements entered into before and after the effective date. It is not clear when the Senate will consider the bill.

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STEVEN SALLEN'S FAVORITE QUOTE BY STEVE YZERMAN

Q: What's the best piece of advice you ever got?

A: When I was a kid, my dad used to tell me "just keep you mouth shut and go out and play hard." That's what I tried to do for the most part.

Quoted from: Detroit Free Press

Utility Company Programs Assist Multifamily Project Owners In Saving Green by Going Green

BY: DANIELLE M. SPEHAR

Energy efficiency became a statewide initiative under the Clean, Renewable and Energy Efficiency Act of 2008. You may have noticed a $1.00 surcharge on your residential energy bill. The surcharge is to fund programs that utilize new energy efficient technology for commercial businesses. Programs being implemented around the State are intended to help create jobs in Michigan, and provide long-term benefits to the environment.

Consumers Energy has created a "Consumers Energy Saving Solutions" program which is designed to help customers use electricity and natural gas more efficiently and save money. This program offers incentives on a defined set of energy efficient equipment generally, on a per unit basis. Incentives are available in the following product categories: Lighting, HVAC, Water Heating, Motor & Drive and Miscellaneous. The program also offers a special incentive for Custom Measures which are not covered by the company's qualifying measures. The custom incentive is based on the estimated annual energy savings of the improvement.

DTE Energy also offers a "Multifamily Dwelling Program." This program offers energy saving upgrades to both tenant (and common areas) for multifamily buildings with five or more units.

With respect to tenant areas and electric service, a utility company views the building owner's tenant as its customer. The utility company will install up to eight compact fluorescent energy efficient light bulbs in every unit free of charge. These bulbs use up to 75% less energy than incandescent bulbs. The installation includes opening ceiling light fixtures and replacement of bulbs. In addition, the utility company will also install low flow shower heads, low flow kitchen and bathroom faucet aerators, and provide pipe wrapping in units with individual hot water heaters. Based upon a building's eligibility for program participation, programmable thermostats may also be available. This program is entirely free and will continue until funding of approximately $10 million for 2009/2010 is exhausted. The owner's responsibility is simply to provide the utility company representative with access to the units.

For common areas, both interior and exterior, the utility company will perform a free walk-through audit with the owner to evaluate both lighting and heating plans. Upon completion of the audit, the utility company will work with your contractor to outline a scope of work which qualifies for the various incentives. You may select only those recommendations you wish to complete from a list of qualified energy-efficient upgrades. You are not obligated to complete all of the recommended improvements. The utility company will pay for 60% to 85% of the entire cost (labor and materials) of making such energy efficient improvements. The amount paid by the owner (the difference of 15% to 40%) of the total cost will be based upon the operating hours of the lighting. For example, common area hallways, where lighting is not turned on 24 hours a day, would qualify for 65% of the cost to be paid by the utility company, while replacing incandescent bulbs with LED bulbs in lighting and exit signs would qualify for 85% of the cost to be paid by the utility company.

At present, these programs are intended to be, long term plans. However, the Michigan Public Service Commission has some authority to modify or stop the programs at any time. Program funds are allocated on a first come, first served basis, so it makes sense to look into your project's eligibility as soon as possible.

You can sign up for DTE and Consumers Energy's respective programs through the following links:

DTE: http:www.dteenergy.com/businessCustomers/saveEnergy/rebates/bizMultiFamily.html

Consumers Energy: http://www.consumersenergy.com/eeprograms/Landing.aspx?ID=750

If your project utilizes both utility services, you will be required to coordinate the programs with each of them. For example, the Consumer Energy program will only pay incentives for measures that save energy served by Consumer Energy. If a qualifying measure saves both natural gas and electricity (such as a programmable thermostat), the owner cannot apply for an incentive for the same measure from both utilities. However, a custom incentive can be paid by two utilities for the same measure if the measure saves both gas and electricity since each utility will only base the incentive on the savings for the commodity they deliver.

At a time when the marketplace is extremely competitive for prospective residents, and cost containment is essential for project success, these programs offer an opportunity to create value for your tenants and your bottom line with a utility partner helping to share the costs of implementation.

Effective January 1, 2010, **Steven D. Sallen** has been appointed **President and Chief Executive Officer of Maddin Hauser Wartell Roth & Heller, P.C.**

Steve is taking over the role from Michael W. Maddin, who served in this capacity for over 25 years. Steve began his legal career at Maddin Hauser in 1983 as a law clerk. Working hard and being dedicated to superb client service, Steve became a shareholder of the firm in 1992. Of course, Steve will continue to service his clients and build his real estate, environmental and corporate law practice.

We all here at Maddin Hauser welcome and support Steve in this new role and wish him a hearty **Congratulations!**

Bargaining With Distressed Landlords

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However, take note of the risk that a letter of credit or escrow may be considered part of a landlord/debtor's estate and could be seized if landlord files for bankruptcy. The parties could establish a right of offset against rent, if the landlord fails to complete the improvements. Or, the parties could simply reduce rent upfront and have the tenant responsible to make the improvements. But here, landlords must make sure tenants do not "take the money and run!" *I.e.*, take advantage of the rental reduction, but do nothing to better the space.

A Landlord's failing financial strength may also lead to deterioration in building and common area maintenance. Tenants concerned about a landlord's ability to timely maintain and make repairs, may want a self-help right to maintain, and to offset costs against rent to cover the expenses incurred. Tenants may also need to consider what levels of building maintenance and other services will be continued if the building winds up in foreclosure and/or receivership.

Tenants should confirm if the landlord has a mortgage. If a lender exists, is there a current or likely future mortgage default? If yes, is the lease "subordinate" to the mortgage? Tenants should review lease terms to determine if a subordination and non-disturbance agreement ("SNDA") in favor of the tenant can be obtained from the lender. An SNDA will assure that the lease stays in place even if lender forecloses its mortgage. Lenders typically are receptive to such agreements, because they help assure that the tenant will pay rent directly to the mortgagee after a loan default. Tenants should also ask the lender to provide a duplicate notice of mortgage default, and, in certain cases (like in a single tenant building), a right to make direct payments to the mortgagee, with a corresponding credit against the rent. Also, tenants should determine whether lease modifications or new leases are permitted without lender consent. Typical loan documents prohibit landlords from amending leases (especially for a rental concession) or entering into new leases without a lender's consent. In assessing leverage, tenants need to know ahead of time how many parties are "sitting" at the bargaining table. And, landlords and tenants beware that dealing with a lender on these issues can take time and patience, and sometimes money.

Tenants negotiating new leases or amendments to existing leases for single tenant buildings, should also consider demanding an option to purchase the leased premises. However, lenders often deem such options as an impediment to their foreclosure rights. Therefore, lenders may withhold their consent to purchase options within a lease unless the option specifically provides that it cannot be exercised against a successor landlord such as a lender after foreclosure or, at a minimum, that the purchase price must pay off the mortgage in full.

As with any negotiation, leverage points can be anticipated by being prepared. Whether the landlord or the tenant, plan out a strategy for success in advance. Identify all of the players involved and the obstacles to success ahead of time. Be creative. And above all, make the deal a win-win for all parties, otherwise the effort is doomed to fail.

Energy efficient and renewal energy saving tips from the Department of Energy:

- ⇒ **Install a programmable thermostat.**
- ⇒ **Plug home electronics into a power strip and turn off the power strips when not in use.**
- ⇒ **Air dry dishes instead of using your dishwasher's drying cycle.**
- ⇒ **Turn off your computer and monitor when not in use.**
- ⇒ **Lower the thermostat on your hot water heater to 120°F.**
- ⇒ **Use compact fluorescent light bulbs with the ENERGY STAR® label**
- ⇒ **Drive sensibly. Aggressive driving wastes gasoline!**

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