Eastern Michigan Real Estate Investment Association

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"Back-up" Offers: Be Cautious! By Dale Alberstone, Esq.

Hello everybody. Let's discuss "back-up" offers this month as they often occur in connection with the sale of apartment buildings, as well as other types of real property.

Real estate purchase contracts frequently contain a provision that the seller may receive back-up offers even though the seller has an accepted offer with the buyer and may even be in escrow. Under real estate law, it is perfectly legal for the seller to include such a provision in the agreement and perfectly proper for the seller to thereafter receive back-up offers from prospective purchasers.

What is not lawful, however, is for the seller to cancel his existing contract in order to accept a higher offer from a new prospective purchaser, even if the offer is substantially higher. Not only would that constitute a breach of contract by the seller, it would also constitute a breach of the seller's implied covenant of good faith and fair dealing.

The law implies in every contract a covenant of good faith and fair dealing. Broadly stated, that covenant provides that neither party do anything which would deprive the other of the benefit of the agreement.

Here is an example of the application of the implied covenant of good faith and fair dealing in a real estate context: Suppose that a seller who is under a $2,000,000 contract with an existing buyer desires to cancel the transaction so that he may accept a new buyer's back-up offer of $2,500,000. Also suppose that the lender requires, as most lenders do, that it's appraiser inspect the interior common areas of the seller's "security" building as a condition to loan approval. Further, suppose that without that interior inspection, the lender would not make the loan. Finally, suppose that the seller refuses to allow the appraiser access to the common areas because the seller anticipates that the lender would not then make the loan and, therefore, the buyer will not be able to consummate the transaction. Cont. page 2

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Under that scenario, the seller would be in breach of the implied covenant of good faith and fair dealing.

Since the motive behind the seller's lack of cooperation was to re-sell the property to the prospective purchaser making the back-up offer, the seller, when refusing common area access (and therefore causing the buyer's loan application to be declined), would be liable to the buyer for damages for breach of the implied covenant.

Similar laws apply to prospective purchasers who submit back up offers. It is perfectly proper for a prospective purchaser to make a back-up offer to the seller even though the prospective purchaser may know of the existence of the seller's contract with the buyer. However, in submitting such an offer, the prospective purchaser needs to exercise caution, lest he be liable to the initial buyer for inducing the seller to breach the contract. That would be particularly true if the prospective purchaser submitted the back-up offer with the intent to induce the seller not to sell the property to the buyer, but to instead sell it to the prospective purchaser.

There are three types of legal theories under which the prospective purchaser may be liable to the buyer. They are:

1. Inducing a breach of contract:

If the prospective purchaser has knowledge of the buyer's contract and intends to induce its breach by submitting the back-up offer, the prospective purchaser may be liable to the buyer for any damages that the buyers suffers because of the seller's breach. Of course, the court would require proof that the prospective purchaser had an expectation that his submission of the back-up offer would in face induce the seller to breach the contract.

While direct proof of the party's state of mind may be difficult to accomplish, our courts have endorsed a maxim of jurisprudence which assists in establishing a person's intent. Paraphrasing it: "A person is presumed to intend the natural and probable consequences of his acts." Pierce v. Nash, (126 C.A.2d 606,6 13).

2. **Interference with the contractual relationship:**

This second theory is slightly broader in that it protects against intentional acts not necessarily resulting in a breach of the contract. If the prospective purchaser commits intentional and unjustified acts designed to interfere with or disrupt the buyer's contract with the seller, the prospective purchaser may be liable to the buyer for damages which the buyer suffers as a result of actual interference with or disruption of the relationship.

3. **Interference with prospective economic advantage:**

This third theory is still broader in that it protects against intentional acts designed to harm an economic relationship which is likely to produce an economic benefit to the buyer even though no contract had yet been formed.

It requires that the buyer have an economic relationship with the seller concerning the probability of a future economic benefit, the prospective purchaser had knowledge of that relationship, the prospective purchaser com-

mitted an intentional and unjustified act designed to disrupt the relationship and the relationship was actually disrupted, causing the buyer damages.

This type of liability arises where the buyer does not yet have a contract but instead has an economic relationship with the seller which would give rise to the probability of a future economic advantage.

While the first two theories of liability are rather straightforward and relatively easy to understand, this third theory is rather nebulous. Generally, it applies to parties who have an on-going business relationship with one another. It would not apply to a seller who is negotiating with a buyer with whom he has never before been involved. For example, it is lawful for a prospective purchaser to submit his own higher offer to a seller even though he knows that the first proposed buyer has submitted an offer which the seller is about ready to accept. (In that circumstance, of course, the prospective purchaser's offer would not be a "back-up" offer because there was no already-existing contract.)

A real estate licensee who receives a back-up offer in behalf of a prospective buyer or presents a back-up offer to the seller also should be careful that he/she does not receive or submit the offer with the intent to cause the seller to breach the contract or with the intent to disrupt the contractual relationship between the seller and buyer. The real estate licensee may have similar exposure for damages to the buyer under the theories discussed above.

Indeed, real estate agents are well aware that they cannot interfere with existing contracts, particularly with respect to listing agreements. A common practice of licensees to avoid exposure for contractual interference is seen in their "direct mail" solicitations. Often, the fine print will say, "If your property is presently listed with another broker, please disregard this mailing."

Concluding remarks

Back-up offers are generally lawful and play a significant role in the sale of real estate. But prospective purchasers, sellers and real estate agents need to be particularly circumspect about presenting or receiving back-up proposals once a contract has been entered into between the buyer and the seller.

If the back-up offer interferes with the sale of the property to the buyer, the buyer may pursue causes of action (i.e. litigation) against the prospective purchaser or licensee for inducing breach of contract or interference with contractual relations. The buyer may also have causes of action against the seller for breach of the implied covenant of good faith and fair dealing as well as ordinary breach of the contract.

Attorneys wishing to further brief themselves on the three different theories of liability should review *Shamblin vs. Berge, 166 C.A.3d 118.* That case presents an excellent discussion of the differing elements and nuances among the three theories in a real estate context.

The foregoing article was authored on January 2, 2013, and is intended as a general overview of the law and may not apply to the reader's particular case. Readers are cautioned to consult an advisor of their own selection with respect to any particular situation.

Whether you are a commercial landlord or a residential landlord, lease assignment by the tenant is certainly something you have considered and likely something you have attempted to address in the lease.

The following provides a refresher on the basics of assignments and lease provision options limiting or conditioning assignments.

ASSIGNMENT BASICS

In the landlord-tenant relationship, the landlord owns the real property (he/she is the "fee owner"), and the tenant, in renting, owns a real property interest (the leasehold interest). As long as the tenant complies with the provisions of the lease, the tenant has the right to exclusive possession of the real property. Without any lease provision specifying otherwise, the tenant is free to essentially sell its own property interest-by assigning the lease to a third party.

ASSIGNMENT VS. SUBLEASE

It is important to note the difference between the assignment of a lease and a sublease. With a lease assignment, the lessee gives up its entire interest in the lease (or its entire interest in part of the leased premises while retaining its interest in the remaining premises). Unless a lease provision requires otherwise, all parties anticipate no further relationship with the assignor. The assignee essentially "steps into the shoes" of the assignor (the original lessee).

In comparison, in a sublease, the original lessee retains a reversionary interest (e.g., a period of time in which the lease reverts to the original lessee). There is no change in the relationship between the landlord and the original tenant. Also, there is no relationship created between the landlord and the subtenant. The original tenant remains liable to the landlord for any breach of the lease, whether by the original tenant or the subtenant, and the subtenant is not entitled to any damages caused by the landlord's improper acts.

(Note: If the original lessee does not actually retain a "reversionary interest" in the premises, a court may, under the common law view (unless changed by statute), hold that the transaction creates an assignment rather than a sublease.)

LIMITS ON ASSIGNMENT

Tenant perspective. A tenant/lessee may want the ability to assign its lease in case: (a) it can no longer afford the space (e.g., to protect against business failure); (b) it outgrows its space (e.g., to provide for business success); or (c) it seeks to sell its business (e.g., to provide for the ability to assign the lease to the business buyer). The greater the size of the space leased or the longer the term of the lease, the more important the right to assign may be to the lessee.

Landlord perspective. Meanwhile, a landlord/lessor may want to limit or condition any lease assignment in order to maintain control over the quality, composition, and financial capability of his or her tenants. For example, the lessor may want to ensure a certain "tenant mix" in the commercial building/complex.

LEASE PROVISIONS LIMITING OR CONDITIONING ASSIGNMENT

Landlords and tenants can negotiate for the rights, limits, and conditions to assign the lease. The lease may provide that:

- The lessee has no right to give assignments under any circumstances (including deeming a change in management to be an assignment).
- The lessee has no right to assign the lease except in specified, limited situations (such as: assignment to an affiliated party; or assignment provided the same use is continued by the new lessee).
- The lessee may assign the lease, but only with the lessor's consent. (Note: courts in most states will allow a lessor to arbitrarily withhold consent, but a few states require a refusal to consent be based on reasonable grounds, and at least one (California) requires by statute that the lessor permit assignments under certain conditions.) In an effort to avoid a reasonableness requirement, the lease can specify that the lessor may withhold consent arbitrarily and capriciously.
- The lessee may assign the lease, but only

Landlord's Quarters conclusion

with the lessor's consent, which cannot be unreasonably withheld.

Whichever limitation is placed on assignment, a lessor to protect its interests, should also ensure the lease requires certain prerequisites be met before an assignment is effective:

- The original lessee remains liable for all obligations under the lease until the end of the original term.
- The lessee, at the time of the assignment, fulfills all its obligations under the lease (and possibly under any other agreements it may have with the lessor).
- An original, executed copy of the assignment must be delivered to the lessor within a specified period of time.
- The assignee sign an assumption agreement whereby the assignee agrees to assume and perform all of the obligations imposed on the tenant by the lease. Also, a copy of the assumption agreement be provided to the landlord within a specified period of time.

OTHER LEASE CLAUSES THAT CAN AFFECT ASSIGNMENT

Other lease clauses, which do not "speak" to assignment or the particular tenant, can affect the ability of the lessee to assign. Examples of common such provisions include: use restrictions; restrictions on alterations and improvements; restrictions on signs; requirement of continuous occupancy and operation throughout the lease term; and required use of a particular trade name.

(Note: Lease provisions that prohibit or restrict assignment of rights are unenforceable under the U.S. Bankruptcy Code. Therefore, it is possible that a lease that was not terminated prior to bankruptcy may be assigned by the tenant.)

Source: Meislik & Meislik Ruminations, Ira Meislik, "Assigning a Lease-Does the landlord really own the property?" (April 1, 2012); www.retailrealestatelaw.com/archives/838.

Source: 1 Real Estate Leasing Practice Manual, §§ 31:1 to 31:29, Alvin L. Arnold and Jeanne O'Neill (April 2013).

Toxic and Black Mold Liability for Homeowners and Landlords

Most states recognize a landlord's responsibility to keep your apartment in livable condition. The risks of breathing in toxic mold spores form the basis of one of the newest areas of personal injury lawsuits between landlords and tenants. However, experts have yet to establish a specific list of molds that are dangerous to people's health. Problems proving that an injury was a direct result of exposure to toxic mold have also made it difficult to pursue this type of case.

Landlords Have a Duty to Maintain and Repair

Most states impose a duty on landlords to keep rental units in livable condition. If mold develops in your apartment as a result of poor maintenance and you can prove it has affected your health, you may be able to file a personal injury lawsuit against your landlord. However, proving the mold caused your health problems can be difficult.

Tenants Responsible for Mold Cannot Blame the Landlord

If the mold in your apartment can be linked to your own actions or negligence, you may not be successful in a suit against your landlord based on a duty to maintain and repair. Leaving windows open while it is raining, failing to allow the landlord access to the apartment for maintenance, improper use of equipment in the apartment that causes high humidity levels, and other circumstances caused by tenants can ultimately relieve the landlord of liability for mold.

Some States and Cities Have Passed Mold Laws

A handful of states, including California and New Jersey, have passed laws to establish acceptable levels of mold spores in indoor air. Certain cities, including New York City and San Francisco, have included mold in their department of health guidelines. If you live in these areas, your landlord has an increased responsibility for mold. You may be able to make a claim against the landlord for violating these specific laws, regulations, and guidelines.

Mold Disclaimers in Leases May Not be Valid

Some landlords may include a clause in the rental agreement that exempts them from liability for mold. It is not clear whether courts will uphold such a liability waiver. At least one court has held this type of clause is against public policy. The validity of mold liability waivers in leases should be established in the futures, as more cases of mold litigation make their way through state court systems.

A Personal Injury Lawyer Can Help

The law surrounding personal injuries sustained from exposure to toxic mold is complicated. Plus, the facts of each case are unique. This article provides a brief, general introduction to the topic.

Real Estate Investing With REITs

from CPA Client Bulletin

As the memory of the financial crisis recedes, the real estate market shows signs of recovery. You may believe excellent investment opportunities exist now—and that might be the case. Nevertheless, you may be reluctant to buy investment property. Inexperienced investors can make costly mistakes, property management will be either expensive or time consuming, major commitments of capital might be required, and investment real estate is illiquid.

For any or all of those reasons, you may consider investing in real estate investment trusts (REITs) as an alternative. You can buy and sell many different REITs, just as you'd trade shares of common stocks. A given REIT can be diversified, and REIT funds provide even more diversifications. What's more, you can invest in REITs with only a few thousand dollars.

Real differences

Broadly speaking, REITs fall into two categories.

Equity REITs own one or more properties. Often, they specialize in various types of real estate. One REIT might own only office buildings, for example, while another REIT might own shopping centers.

Mortgage REITs own debt instruments. They buy existing mortgages, collect payments from borrowers, and pass the money through to investors.

Some REITs are hybrids, owning both properties and mortgages.

Investment implications

In a way, all REITs are hybrids. Equity REITs, for instance, reflect the performance of both the real estate market and the stock market. In a strong real estate market, property values rise. Higher property values, in turn, tend to boost the prices of REIT shares.

On the other hand, a stock market crash can sink equity REITs. From May 2008 to February 2009, for example, the Financial Times Stock Exchange National Association of Real Estate Investment Trusts (FTSE NAREIT) U.S. Equity REIT Index fell by 62%, as the stock market collapsed. The values of the office buildings, shopping centers, and other properties held by REITs may not have dropped to the same degree. (Since that bottom, more than four years ago, this equity REIT index has more than tripled. As of this writing, it is 28% higher than in May 2008.)

While equity REITs are a mix of stocks and real estate, mortgage REITs combine the features of real estate and bonds. The yields paid to investors reflect interest rates on real estate mortgages. These REIT shares, however, tend to trade with the bond market: if interest rates rise in the future, mortgage REIT shares probably will fall along with bond values.

Tax treatment

Under the U.S. tax code, REITs are required to pay investors at least 90% of their taxable income each year. This payout reduces or eliminates a REIT's obligation to pay corporate income tax. By comparison, dividends paid to investors by regular corporations may be taxed twice: both the company and the investor can owe tax on those dollars.

As a result of this tax treatment, REITs generally have relatively high yields. In 2013, equity REITs generally pay around 4% to investors. By comparison, the yield on the Standard & Poor's 500 Index of large company stocks is around 2%. Mortgage REITs currently yield about 7%, versus 3% for U.S. corporate bond indexes.

Besides the high yields, REIT investors may benefit from favorable tax treatment.

Example: Jill Young invests $10,000 to buy 200 share of ABC Office Building REIT at $50 a share. In 2013, Jill receives a $400 (4%) dividend. On the IRS form 1099-DIV that ABC sends to Jill, she sees that $100 is a long-term capital gain, $100 is ordinary income, and $200 is a return of capital. Therefore, Jill will owe tax on $100 at favorable capital gain tax rates and $100 at ordinary income rates. She'll owe no tax on her $200 return of capital. (Generally, REIT dividends do not get the special low tax rates on "qualified" dividends.)

Although Jill avoids tax on her $200 return of capital in this example, she must lower her basis by $200—$1 per share—to reflect her $200 return of capital. This reduction drops her basis from $50 to $49 and will increase the tax she will owe in the future on a profitable sale. Nevertheless, the REIT tax treatment works in Jill's favor, because she avoids paying ordinary income tax now and may owe tax on a future sale at lower capital gains rates.

Building out

The REIT universe is broad, covering many varieties of investments. Some REITs do not trade publicly; they might offer higher yields but also restrict your ability to sell for many years. Other REITs have been created outside the U.S. These global REITs may offer profit potential, in fast growing regions, but they also might have specific risks found in local markets.

Altogether, carefully selected REITs may deliver substantial cash flow, portfolio diversification, and participation in real estate growth. Be sure to look closely at any REIT before investing, so you're confident you understand the risks involved.

Landlord "Never Agains" Tips on Management: by Jeffrey Taylor

Once a landlord has been in business a while and learned a few things "the hard way" there often comes a point where he or she stops and makes the declaration, "NEVER AGAIN!" Well, the following is a list of those shared by landlords nationwide to help them avoid very costly problems in 2013.

- Never again think of this landlord thing as anything but a business and treat it like that.
- Never again think that existing rents are low because of the current owner is renting to scumbag lowlifes. In case you wonder, renting to scumbag lowlifes actually commands higher rents since there are fewer options for them. Think about it, anyone will rent to someone with good credit and no criminal past. I won't make that mistake again in thinking that after buying a place, I can clean it up and rent it for more without having a complete understanding of market rents.
- Never again buy a place where rents just cover the payments.
- Never again buy a place without measuring the square footage to compare against the listed square footage.
- Never again plan to contribute my own labor for free when estimating fix-up costs because I don't have enough cash to pay someone else to do the fix-up.
- Never again bet on appreciation or buy a property that does not make me money from the get go.
- Never again buy in an area I don't know because the price looks good compared to what I do know.
- Never again believe anything that comes out of the mouth of a City Employee about a property I own or am about to purchase without checking it out for myself.
- Never again believe I can't be successful at something just because EVERYONE says it won't work. Like being a landlord, for example.
- Never again believe because I made a mistake today I can't do better tomorrow. Keep believing in your dream. If we did not fall down, we would never learn to walk.
- Never again believe I have to go at it alone—because there are so many willing to freely give of their knowledge just because I asked for help.
- Never again go against my gut feeling.
- Never again pay workers by the hour.
- Never again pick up rent in person or allow it to be mailed—auto drafts or direct deposit only!
- Never again give up the keys before having the cash and contract signed.
- Never again rent to someone who sees the house for the first time, pulls out a wad of cash, and says, "I'll take it!" without screening them first.
- Never again "hold" an empty unit for anything longer than two weeks.
- Never again ask a resident casually, "How's everything going at the apartment?" Ha-ha, nothing good will ever come from asking a resident THAT question!!!!
- Never again rent to family/friends.
- Never again install carpet in a rental. NEVER!!
- Never again NOT do a background check on a sweet old lady that turned out to have a felony for selling prescription drugs!! Sort of a happy ending though—she's been with me for five years. Quiet and always paid on time.
- Never again think that simply because we have a signed lease, the place is rented for a year. I must also utilize smart resident retention strategies.

The above tips are shared by regular contributors to the popular MrLandlord.com Q and A forum.

From Fannie + Freddie

by Keat Foong, Multi-Housing News

The FHA financing program, too, grapples with various challenges

Multifamily housing has been the fortunate beneficiary of Fannie Mae, Freddie Mac and FHA financing programs. While the two Government Sponsored Agencies are not targeted for elimination, the Federal Housing Administration (FHA) multifamily loan insurance programs, as it turns out, may not necessarily escape existential threats either. It appears the same questions about the role, size and risks of the government agencies can also be applied to the FHA.

In the latest development, the Protecting American Taxpayers and Homeowners (PATH) Act, which has been introduced in the House, proposes to impose affordability requirements on multifamily properties receiving FHA insurance. "FHA is clearly facing legislative challenges," agrees Claudia Kedda, senior director, Multifamily and Affordable Housing Finance. "Efforts to reform the single-family program have put pressure on HUD to also take steps to mitigate risk on the multifamily side."

Besides possible legislative pressure to overhaul the decades-old FHA financing insurance program, developers who use the FHA mortgage insurance programs, whether for construction or acquisition financing, are also meeting other challenges: FHA's impending exhaustion of loan commitment limit of $25 billion, the reorganization and reduction of the number of HUD field offices, and FHA risk mitigation measures.

All these pressures on FHA are coming at a time of unprecedented demand for the FHA multifamily and healthcare insurance programs. As a sign that the economy is improving, commitment authority is being used at a significantly faster pace than last year, says Kedda. "FHA, Fannie Mae and Freddie Mac continue to provide the bulk of financing for multifamily rental housing at this time," says Kedda.

On the legislative front, the PATH bill would require FHA multifamily loans to meet occupancy and rent requirements based on area median income, as well as separate FHA from HUD. The bill, sponsored by Jeb Hensarling (R-Texas), aims to "slim down FHA in general," comments Steve Wendel, executive managing director of Berkeley Point Capital LLC. "There is political pressure from Congress, and political debate on the proper size of FHA and the government's role."

Steps to mitigate risks on the multifamily side have already been undertaken, but there is pressure to narrow FHA's mission, and impose capital reserve requirements on the insurance fund which is not currently required by statute, adds Kedda. "These are concerns for NAHB," says Kedda because they can affect the availability and cost of financing for a broad range of housing.

Stillman Knight, president and CEO of The Knight Company, and deputy assistant secretary for Multifamily Housing Programs at the FHA office at HUD from 2003-05, would not brush off the seriousness of these legislative initiatives. "I am very concerned that the conversation on the Hill represents a significant threat to the traditional role of FHA," says Knight.

Knight says that of the three concerns, supplemental funding, multifamily reorganization and FHA reform, "the greatest threat in my mind is the idea on capitol hill that housing no longer fulfills a public purpose and should be financed by the private sector without a government backstop. Our housing finance system is the envy of the world, and we will not make it better by abandoning the basic principles that made it so. Since, 1934, FHA has been able to provide a cushion during recessions and for underserved areas of our great nation. It does so by serving a broad range of capital structures providing diversity and strength to its business model and its mission."

Kedda adds that the vast majority of FHA-insured rental properties already serve households well below the 115 percent of area median income limit that is included in the draft discussion bill. Such income limit requirements may also mean requiring developers and property managers to income certify over the life of unsubsidized loans, which is "burdensome, costly and unnecessary," she says.

For Wendel, besides the legislative threat, the greatest challenge facing FHA is the plan to consolidate the HUD multifamily field offices over the next three years. The biggest question is "how you can manage a major consolidation and retain staff at the same time. A lot of the staff may choose not to move," says Wendel. A related question is the impending retirement of the experienced and skilled staff, with more than half the staff eligible for retirement in the next few years, said Wendel.

"Certainly, the [HUD filed office reorganization] is going to be difficult on the staff and the customers who build relationships in the local offices-no question about that," adds Knight.

Loan commitment is another issue that has emerged in recent months, as it has in prior years. In June, HUD announced that because it was approaching its $25 billion loan commitment authority for FY 2013, it would have to prioritize remaining applications. Priority will be applied in the following order: projects affected by Hurricane Sandy, affordable transactions, and market-rate transactions.

As NAHB points out, the commitment authority does not cost the federal government money, as the FHA mortgage insurance premium generates enough revenue to cover the cost. FHA has requested an additional $5 billion for the remainder of FY 2013. However, NAHB said, it is unlikely that Congress will grant HUD the additional commitment authority before the August recess, although in years past industry efforts to convince Congress to pass bills to provide enough commitment authority until the new fiscal year have been successful and the programs continued uninterrupted.

"In this very difficult economic environment, and with continuing issues related to the FHA single-family programs, there is great reluctance by Congress to allow a bill to solve this problem," says Kedda.

On the plus side, HUD did request $30 billion in commitment authority for the FHA multifamily and healthcare programs for the next fiscal year, FY 2014, which starts in Oct. 1. So far, both the House and Senate appropriations committees have included the higher funding number of $30 billion in the HUD appropriations bill, says Kedda.

Nevertheless, as an indication of the high level of demand for the program, even this increased funding for FY 2014 may not be enough. "There are many commitments that are waiting in the queue right now for Oct. 1 authority to be available, and those will continue to stack up," reports Tyler Griffin, vice president of originations at Beech Street Capital. "This means a large number of transactions will be committed in the first quarter of HUD's FY 2014, causing some concern about the authority again running out before the second half of FY 2014.

Griffin suggests that the resulting delays caused by the dwindling FHA authority can kill deals in an environment of rising interest rates. Other deals that were time-sensitive had to be refinanced via alternate sources, whether the GSEs, or CMBS. However, only about 20 percent of Beech Street's transactions have been affected by lower proceeds or had to be refinanced. Many "HUD borrowers are generally prepared for timing issues and have started working on their transactions with a good cushion in place. A 45-day wait for new authority hasn't put them in the red," says Griffin.

While the amount of FHA commitment may still be a problem, others in the industry seem less concerned that legislative challenges will be serious. There is strong political support for the FHA program in general, including support from the HUD secretary and the Obama Administration, says Wendel. "Hensarling really wants to reduce the footprint of GSE and FHA. But personally, I don't think there is support for that type of radical restructuring of housing," says Wendel.

"The House proposal represents the right in its proposal to reform FHA and the housing finance system, but unfortunately, the senate proposal doesn't vary enough from the House proposal to offer a reasonable comprise in a subsequent negotiation," says Knight. Stay tuned.

What is Hoarding and How Should a Landlord Deal With It? By Bruce Kahn, CCIM, CPM

Thinking I would start with a definition of hoarding, I went to the Merriam-Webster dictionary—**"to collect and hide a large amount of valuable items."** Obviously, Merriam-Webster never owned rental housing.

Undaunted in my search, I went to Wikipedia and found what I was looking for. Hoarding, also known as pathological collecting, is a pattern of behavior that is characterized by excessive acquisition of and inability or unwillingness to discard large quantities of objects that cover the living areas of the home and cause significant distress or impairment. Further research found that this had not yet become an accepted "medical" diagnosis. Fortunately for landlords, hoarders are not a protected class and they have the right to require the hoarder to clean their units or face eviction. The question begs to be asked whether this is a modern day phenomenon. While interesting, it does not address what a landlord should do if a tenant is discovered to be a hoarder.

I have dealt with this situation on multiple occasions. It crosses all stratas of income and can just as easily occur in a $2,500 unit or a $550 unit. Typically, hoarders are discovered during a maintenance inspection or from complaints from other tenants about strange odors coming from the hoarder's unit.

An important thing to remember when dealing with a hoarder is more than likely the person suffers from some form of imbalance. As frustrating and absurd as it may seem, the items being hoarded represent something of great importance, for whatever reason, to the individual you are dealing with.

Please note the words "unwillingness or inability" to discard objects.

Simply put, you will have very little, if any, success trying to persuade a hoarder that they should discard their treasured stash. Consequently, an owner or landlord has only two choices.

1. The first and most obvious would be to send the tenant a notice to comply or vacate. [AOA's form, Cure the Violation or Move Out]. Sometimes this may cause a tenant to clean their unit. However, more often than not, it quickly returns to the way it was. Usually this path ends up in an eviction of the tenant, which creates further economic loss for the landlord. I always try to convince tenants to leave on their own and agree not to pursue them if they leave the unit in a clean condition. This saves months of lost rent and legal fees.

2. Some may consider this unorthodox, however, if I do discover a hoarder and what they are hoarding does not create a health, safety or issue for other tenants—or themselves—I have allowed them to remain in the unit. Typically we will have to do a very expensive turnover when they depart. It often makes more economic sense to keep them in place. The positive of this path is that hoarders seldom move. What would they do with their priceless possessions?

The only caution is the "health and safety" of the other tenants. In some extreme cases, hoarders may be collecting something that would have an impact on the health and well-being of other tenants. Another very important item is to make sure their hoard is not placed near a water heater, furnace or anything else that may create a fire or flood.

Surprisingly hoarders, when met outside of their unit, appear to be normal. They can be cleanly dressed and functioning. With this in mind, as in all issues regarding real estate, the answer of what to do when faced with the issue remains. It all depends. Weigh out the appropriate path to take.

Important Items to Get at Closing

from Michigan Landlord

When buying a rental property, there are a few things that are often forgotten because they are not part of buying residential real estate for personal use. These things can cause problems down the line after taking ownership. Here are some of the most common things new landlords miss at the closing when buying their first unit.

SECURITY DEPOSITS—

Security deposits held by the seller of the property should be transferred to the new owner. Deposits are the property of the tenant-not the seller-until a legal claim (Notice of Damages) can be made against them after the tenant vacates the property. The purchase agreement should note that all security deposits will be transferred to the buyer at the closing. If you're buying a property at a foreclosure sale that has tenants, understand that those tenants may have paid a security deposit to the previous owner and may demand its return upon terminating their tenancy. Copies of the Inventory Checklist completed by the tenant at move-in should also be transferred to the new owner. Without copies of the Checklist, it may be near impossible to prove that the existing tenant caused the damage.

NON-REFUNDABLE FEES—

Some landlords require a non-refundable cleaning fee or pet fee. While these fees are not required to be returned to the existing tenants, the funds might come in handy if the tenants leave the unit in a serious mess. If the seller doesn't transfer the funds, they've pocketed additional cash from the deal.

LEAD BASED PAINT DISCLOSURES—

If you're buying a property built before 1978 with existing tenants, you should ask the seller for copies of the lead-based paint disclosures given to the tenants and signed by the tenants and the seller (landlord). If the seller does have the disclosures and they have noted on the disclosures that they have knowledge of lead hazards in the property, you should also obtain copies of the paperwork from the inspections carried out. Copies of these inspection reports must be made available to tenants upon their request. If the seller does not have the federally required documents, you should immediately provide the disclosures to the tenants and the EPA booklet entitled "Protect Your Family from Lead in Your Home" after taking possession of the property.

LEASES AND OTHER DOCUMENTS—

While not always possible, getting a copy of any and all existing leases can be very helpful. In fact, it is best to ask for copies of these agreements as a contingency of the purchase agreement. If all the tenants are on long-term leases, it may pose a problem if your plan is to rehab the entire building or raise the rent. You should also check to make sure the lease is a legal lease under Michigan law. Some landlords are not aware that specific language is not allowed. You may need to execute new leases or provide addendums to existing leases to correct unlawful language or to provide disclosures required under law in a lease.

In short, it is highly advisable, if you're new to investing, to use a licensed real estate professional that is experienced with rental property. Proper due diligence is really important when making an investment of your hard earned cash. Experienced buyer's agents should help do the research (or at least know what to research) before helping you making an offer and know what items should be required contingencies or provided at closing.

The Accidental Discriminator by Jeanne McGlynn Delgado, NMHC

Forty-five years have passed since President Lyndon B, Johnson signed the watershed Fair Housing Act into law, putting a symbolic end to systematic and intentional housing discrimination. While overt, intentional acts of discrimination can be more easily identified and remedied pursuant to the Fair Housing Act, thousands of housing discrimination cases are filed each year in the country, indicating the ongoing need for fair housing laws.

However, earlier this year, the U.S. department of Housing and Urban Development (HUD) issued a final rule that has left many housing stakeholders wondering how far the government's definition of housing discrimination will stretch and whether the industry could soon be facing an impending surge in complaint and enforcement activity. The rule formally implemented a so-called "disparate impact" standard of liability, which applies to a business practice or policy that is neutral on its face but nevertheless demonstrates a statistically discriminatory effect on persons protected by the Fair Housing Act, even if there is no evidence of an actual intent to discriminate. The Fair Housing Act does not specifically address effects-based discrimination, but courts and agencies have inferred such liability in employment, housing and related contexts for years.

While HUD maintains that the rule essentially just formalizes its long-standing position on disparate impact, many legal, housing and finance experts see the new rule as a noteworthy expansion of the law with potentially significant repercussions for apartment owners and managers. And even if it only formalizes existing rules, it sets a clear road map for bringing disparate impact actions going forward. At issue is that apartment firms may institute a seemingly neutral business policy-occupancy limitations, resident screening requirements and Section 8 voucher policies, for example-that unintentionally but adversely affects members of a protected class, rendering them liable for discrimination claims despite no intention of singling out a particular group for adverse treatment.

Theory into practice

In practical terms, a number of often-endorsed business practices are coming under scrutiny for potential disparate impact liability, particularly as some state and local governments move to establish their own fair housing laws and expand protections within their jurisdictions to include marital status, sexual orientation, source of income or political affiliation, to name a few.

Criminal background checks are a good example. Apartment owners and managers often screen resident applicants for criminal history, citing the legal duty to provide quiet enjoyment and a secure environment for their tenants. This is in line with the criminal background checks that the government requires owners of HUD-insured and assisted housing to ensure residents have no recent history of violent crimes or drug dealing. Some states and localities, however, have adopted laws that formally limit the ability of owners to impose such screening policies. Even where there is no formal law on the subject, however, some advocates have used disparate impact theory to attack criminal screening, asserting that broad-brush, no-record policies have a harsher impact on some protected classes than others and, therefore, have a discriminatory impact.

Income-related policies also could become a lightning rod issue under disparate impact. Presently, a person's purely economic status-for example, receipt of alimony, public assistance, or Section 8 vouchers—is not itself a protected class under the federal Fair Housing Act. Nevertheless, some states and localities have made "source of income" a protected class under their fair housing laws. And as with criminal screening rules, some advocates are starting to leverage disparate impact theory to extend fair housing protections to economic status, arguing that certain business practices, such as minimum income requirements and rent-ratio policies, violate the federal Fair Housing Act, because they disproportionately affect minorities that are protected classes under that law. Here again, disparate impact is being used to attack widely adopted rules and practices, not because they expressly violate the Fair Housing Act, but because of their potential disparate impact on a protected class.

Along those same lines, credit requirement and qualifications are potentially problematic, not just for apartment firms but also housing lenders and insurers. Stricter, post-recession financial requirements and underwriting practices could disadvantage certain groups, leading to greater disparate impact liability risk.

That said, some housing and legal experts contend that this disparate impact rule could also work in housing providers' favor, helping providers' overcome particularly stringent local zoning laws and ordinances that have historically been unfriendly to new apartment development.

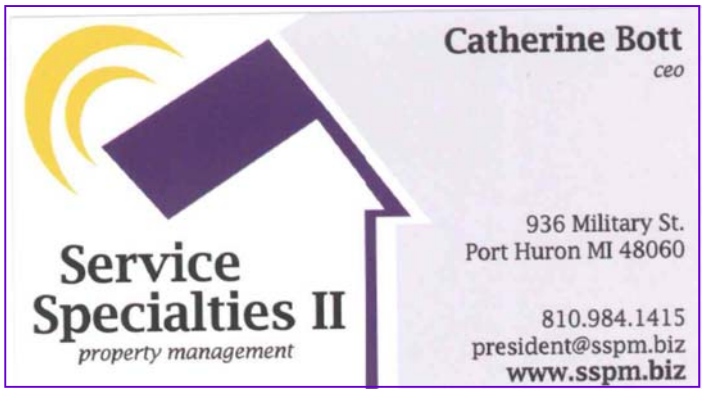
The debate continues

The heart of HUD's new rule, which recognizes that the courts have used various standards to prove disparate impact liability in the past, formalizes a national, uniform three-step, burden-shifting test for determining violations. In the first step, a person alleging injury must show that the challenged practice has a disparate impact on a class of persons protected under the Fair Housing Act. If so, the burden switches to the apartment firm, requiring it to prove that (1) the policy in question has substantial, legitimate and nondiscriminatory interests supporting it and (2) no less discriminatory alternative exists. If the apartment firm meets that burden, the burden shifts back to the complainant to show that there is in fact a less discriminatory alternative.

Adding to the discomfort around these potential liability issues is that HUD rejected so-called "safe harbors," which, by assuring no liability if certain minimal standards are met, typically give companies some flexibility in establishing and documenting efforts to meet compliance standards. HUD cites the decisions of 11 federal courts of appeals and various agency guidance, policy statements and case law to bolster its position.

While the courts have applied disparate impact in housing cases for many years, it remains no less controversial. In fact, the U.S. Supreme Court has been critical of fault without intent rulings in discrimination cases. In June 2013, the Supreme Court announced that it will review the appellate court's decision in Mount Holly v. Mount Holly Gardens Citizens in Action Inc., a case that involves the redevelopment of a blighted New Jersey neighborhood occupied mostly by low-and moderate-income minority households. A decision on the case could determine once and for all whether disparate impact claims are allowed under the Fair Housing Act.

But for now, housing providers have to be keenly aware of the multitude of contexts in which disparate claims could arise and cast a critical eye on company policies that, although considered standard business practices, may create liability if they have a disparate impact on protected classes.



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