



CURRENTS

Inside
this
issue:

New CA Law
Dramatically
Affects
Residential
Foreclosures

2007
Mortgage
Forgiveness
Debt Relief
Act

Boilerplate
Stuff You
Don't Read

Adoption of
Adults

New California Law Dramatically Affects Residential Foreclosures

By Jamie L. Winter

By all accounts, it was a devastating year for struggling homeowners across the nation. In an effort to address the skyrocketing foreclosures that have resulted from lending practices in the subprime market, numerous bills were introduced in the California Legislature this year. One of those bills, Senate Bill 1137, made it to Governor Schwarzenegger's desk and the Governor signed

the urgent measure on July 8, 2008. The Bill implements important foreclosure process reforms to protect the hundreds of thousands of Californians who are in danger of losing their homes due to the mortgage crisis.

According to the text SB 1137, statistics released by the Hope Now Alliance (a private sector FHA refinance program launched on October 1st) demonstrate that the number of completed foreclosure sales in

California tripled between the first and fourth quarter of 2007, jumping from 1,902 to 5,574. The Alliance released related statistics showing that the number of completed California foreclosure sales for January 2008, 10,556, was a staggering two times the number for the fourth quarter of 2007. See SB 1137, Section 1(b).

Provisions of the new law apply only to loans secured by owner occupied residential

(continued on page 4...)

2007 Mortgage Forgiveness Debt Relief

By Cassell von Baeyer

On December 20, 2007, Congress enacted the Mortgage Forgiveness Debt Relief Act of 2007. Prior to this Act, debt forgiven, whether by foreclosure, short sale or loan modification was treated as income (because it is a benefit to the taxpayer) and was therefore subject to taxation. Clearly, this is a result that compounds the financial issues for someone who is forced to let their primary residence go. The act allows taxpayers to exclude debt forgiven on their principal residence if the balance of their loan was less than \$2 million dollars (\$1 million

for a married person filing separately).

This is an important tax relief measure for individuals who sold a house in a "short sale" (a sale where the purchase price is less than is owed on the property and the lender agrees to forgive a portion of the loan amount), homeowners who were able to renegotiate home loans in which a portion of the loan (interest or principal) was forgiven or individuals who had debt forgiven in connection with a foreclosure. There are some substantial consequences and nuanced elements to this new legislation that can severely limit a taxpayer's ability to avoid taxation

of forgiven debt.

In summary, the 2007 Debt Relief Act applies only to forgiven or cancelled debt used to purchase, build or substantially improve your principal residence or to refinance debt incurred for those purposes. Debt incurred to refinance a primary residence qualifies for the exclusion, but only to the extent the principal balance of the old mortgage, immediately before the refinance would have qualified. The 2007 Debt Relief Act applies to debt forgiven in 2007, 2008 or 2009. Now, before you tackle the example below, you might want to reread the underlined

(continued on page 2...)

2007 Mortgage Forgiveness Debt Relief Act

“There are some substantial consequences and nuanced elements to this new legislation that can severely limit a taxpayer’s ability to avoid taxation of forgiven debt.”

(continued from front page...) language, because the devil is always in the details.

Example: In 2002 Bob purchased his principal residence for \$880,000. He put down \$80,000 and borrowed \$800,000. When the fair market value of the home increased to \$1,000,000 in 2004, Bob refinanced for \$850,000 and pulled out cash which he used to purchase a boat and pay off credit cards. At the time of the refinance, the principal balance on the original loan was \$740,000 which means that he pulled out \$110,000 for the boat and credit card payoffs. In 2008, Bob lost his job and the fair market value of the home had diminished to \$735,000. Bob’s lender agreed to modify the loan and reduce the principal amount of the note to \$735,000 thereby cancelling \$115,000 of debt. Under the new Debt Relief

Act, Bob will only be able to exclude \$5,000 from income and the remaining \$110,000 will be subject to taxation. Why? Because the \$110,000 Bob pulled out of the home was not used to purchase, build or substantially improve the home. It was used to buy a boat and pay off credit cards. But he does get to exclude the \$5,000 because that is the portion of the forgiven debt attributable to the principal balance of the old mortgage before the refinance (remember he had paid down his original \$800,000 loan to \$740,000). And if Bob had waited until 2010 to modify his loan? Well under the current version of the Debt Relief Act, Bob would be looking at taxation on the entire amount forgiven.

Debt forgiven on second homes, rental property, commercial property and consumer loans (credit card and car loans) does not

qualify for the new tax relief. However, there may be some tax relief for investment property owners (and for primary residence only owners who may not otherwise qualify under the Debt Relief Act) in the event of insolvency or Chapter 11 bankruptcy. Another option for investment or commercial property owners may be to utilize a 1031 exchange. Investment property owners should contact a 1031 exchange specialist for more information.

There are many nuances and tax implications with this new legislation and already existing tax laws. *Before short selling, modifying your loan or letting your home go in a foreclosure action, we strongly recommend that you consult with your CPA or tax advisor to fully understand the potential tax impact to you of any debt forgiveness.*

Boilerplate Stuff You Don't Read

By Andrew N. Wolf

A lot of our clients have been fortunate to work for many years on a simple handshake. Often, people do not learn about the shortcomings of their self written business contract forms until they are in a dispute and they bring their contract to their lawyer to examine. The second-guessing of the agreement then begins. Sometimes, the client learns a lesson from the loss that results from the weak contract; sometimes not. Some surprisingly simple terms can turn a short contract into a useful tool, should you need it to support a lawsuit or negotiate a favorable settlement. Here are some of the simple provisions that can make or break your success in a lawsuit.

Attorneys Fees Clause -- language that says the winner also gets his attorneys fees.

Why? Under the “American Rule” you generally cannot recover attorney’s fees in most states, unless you have a right to attorney’s fees in your contract or under a special statutory remedy. You need an attorney’s fee clause that is properly drafted.

Clear Payment Deadlines and Interest Provisions -- terms that state when payment or performance is due and the consequences for delay. Why? Disputes can take a long time to resolve. The accrual of interest can become a powerful bargaining chip, and a significant item of recovery. Interest compensates you for the loss of use of your money, and, to some degree, the loss of your own time devoted to the case. Allowable interest rates vary according to the applicable state law. If you want to charge “compound interest” --in other words, interest on interest --

this must be explicitly stated in the agreement. Otherwise, only simple interest will accrue on the principal sum due. Typically, we see contracts with no interest rate stated; the interest rate only appears in invoices. The interest rate(s) should be agreed up-front in the contract

Choice of Law, Consent to Jurisdiction, and Venue -- where a lawsuit must be filed and what law will apply. Why? Cases can be won or lost based purely on the financial burden caused by the location of the lawsuit or arbitration hearing. You want to be in your own home “court,” spending nights at home with your family, trying the case with your favorite lawyer.

Correct Naming of the Parties and Authorized Signatures -- are you actually signing a

(continued on page 3...)

“In these turbulent economic times, it makes great sense to improve your leverage and chances of collection, and perhaps even ward off disputes, by improving your standard contract forms...”

Adoption of Adults

By Stacey F. Herhusky

Most people are familiar with adoption of children, but many people do not realize that there is also a procedure available for the adoption of adults. There are several circumstances that make this a great opportunity for families to explore. In the age we live in, divorce is common and the mobility of our society is always increasing. Children are often raised by step parents or other individuals who are not their natural parents, playing an important *de facto parent* role in a child's life. During the child's minority (e.g. up to age 18), it is not possible to adopt a child without the consent of the child's natural parent or grounds to terminate the relationship between the child and its natural parent. Nevertheless, the *de facto parent* may establish very close bonds with a child and desire to legally solidify the nature of their relationship, even if it is after the child has grown.

Once the child turns 18, the adult adoption process is a

wonderful opportunity to do this. Adult adoptions provide a means to legally recognize the relationship and also secure inheritance rights and other rights for the child from the stepparent. Even if a stepchild has been raised in a stepparent's home for their entire life, the adult stepchild would not be eligible to inherit by intestacy from a deceased stepparent. The adult adoption is the perfect remedy for this type of circumstance. It is important to note that the adult adoption does not have any impact on the relationship between the child and his natural parent and does not preclude the child from inheriting from his natural parent through the laws of intestacy as well.

Adult adoptions can also assist in aiding a young person to legally immigrate to the United States. It bears mentioning that the best time to accomplish the adoption would be before the child reaches the age of 16. However, even if the child has already reached the age of majority, the adult adoption is another factor that may assist the person's ability

to achieve legal immigration.

The adult adoption procedure is very simple and does not involve much in terms of time or money. There is rarely a home study or investigation by a social worker required and there is only a small amount of court filings necessary. Only one court appearance (which can even be waived under certain circumstances) is required by statute. It is always important to be vigilant in reviewing your estate plan to determine areas which need improvement. If you have been part of a blended family, adult adoption may provide a component which may be currently lacking in your estate plan. Most importantly, it has the effect of not only enhancing and legitimizing the bonds of a blended family, but also providing for much needed security to stepchildren after they have grown.

If you have any questions regarding adult adoptions or would like to set up a consultation to discuss this further, please contact Stacey Herhusky.

"...the de facto parent may establish very close bonds with a child and desire to legally solidify the nature of their relationship, even if it is after the child has grown."

Boilerplate Stuff You Don't Read

(continued from page 2...)

contract with the party you think you are dealing with? Some level of due diligence is always appropriate. Why? If you are doing business with a corporation or other entity, you want your contract signed by a properly authorized representative with the corporate name properly stated. You would be surprised how often this is overlooked. Are you dealing with the true property owner, or his uncle who just got out of jail? There is a wealth of publicly available data available on the Internet to verify the correct names of corporations and the true owners of property, businesses, etc.

Personal Guaranties – an additional source of payment if the contracting party defaults; usually a person with money, property or both. Why? It doesn't take much for an unscrupulous person to form a corporation or an LLC. If you do not have a solid track record of doing business with a business entity or trust, it may be appropriate to ask for a personal guaranty. Guaranties must be in writing to be enforceable; they can vary from a single sentence to multi-page guaranty agreements.

Conclusion – A few boilerplate terms can make your standardized commercial agreement an advantage for you in a dispute, or at least keep the playing field

level. We have listed a few of them above. In many cases, a court cannot rescue you unless you give it the ammunition to do so. In these turbulent economic times, it makes great sense to improve your leverage and chances of collection, and perhaps even ward off disputes, by improving your standard contract forms with the simple tools mentioned above. We are always happy to review our clients' standard contracts and provide advice that will make your contracts even stronger.

In the next issue of this newsletter, I will discuss the use of standard warranties, insurance and indemnification provisions.

"If you are doing business with a corporation or other entity, you want your contract signed by a properly authorized representative with the corporate name properly stated."

New California Law Dramatically Affects Residential Foreclosures

(continued from front page...)

real property and secured between January 1, 2003 and December 31, 2007. The provisions will remain in effect until January 1, 2013.

According to results of a survey released by the Federal Home Loan Mortgage Corporation and cited by the Legislature in SB 1137's text, 57 percent of the nation's borrowers who are late in paying lenders are not even aware that the lenders may offer alternatives to assist borrowers in avoiding foreclosure, including loan modification, see SB 1137, Section 1(e). Loan modification may include, among other things, a reduction in interest rates, principal reduction or a term extension.

The Bill requires lenders to meet with borrowers and go over the options available to avoid foreclosure prior to a lender filing a notice of default. Specifically, lenders may not file a notice of default until thirty days after contact is made with a borrower. See SB 1137, Section 2(a)(1). Lenders who are unable to set up a meeting with borrowers can begin the foreclosure process thirty days after they have demonstrated a good faith effort to work with the homeowner.

Contact by a lender must be made in person or by telephone to assess the borrower's financial position and explore the borrower's options to avoid foreclosure. During the initial contact between lender and borrower, the lending agent must advise the borrower that he or she may request an additional meeting and, if requested by the borrower, the lender must schedule the meeting to occur within fourteen days. See SB 1137, Section 2(a)(2).

A notice of default must

contain a lender declaration that a lending agent has contacted the borrower or used due diligence to try and contact the borrower or that the borrower has surrendered the property to the lender. Section 2(g) of the Bill defines in detail the due diligence requirements imposed on lenders. As part of the due diligence requirement, the mortgagee, beneficiary, or authorized agent must post a prominent link on the homepage of its website (if any) to information about the options that may be available to borrowers unable to afford their mortgage payments and who wish to avoid foreclosure and instructions advising borrowers how to explore the various options. See SB 1137, Section 2(g)(5)(A).

SB 1137 also aims to protect communities affected by the recent wave of foreclosures. The Bill requires lenders to maintain foreclosed properties to prevent nuisance and blight and subjects those who fail to meet such requirements with fines. See SB 1137, Section 5 (a) (I). This may be an important provision for stabilizing property values.

The Legislature also considered the rights of tenants inhabiting properties facing foreclosure. The Bill requires lenders to notify a resident of a threatened property about the property's status. Lenders must provide at least sixty days to vacate a property in the event of a foreclosure. See SB 1137, Sections (4)(a) (e) and 6(a) (c)).

According to statistics released by the Center for Responsible Lending, almost 2.2 million subprime foreclosures will occur nation-wide in late 2008 through 2009 and 40.6 million homes in neighborhoods surrounding those foreclosures will suffer price de-

clines averaging over \$8,667 per home and resulting in a \$352 billion total decline in property values. The Center estimated that in California alone, 500,000 families in California would lose their homes due to foreclosure. It would seem, however, that legislation like SB 1137 is a step in the right direction in reducing these staggering numbers. It is likely that other states, like Nevada, will follow suit and initiate similar legislation.

Mortgage industry insiders like Dave Colarchik of Tahoe Lending Group, Inc., believe that banks are showing an increased propensity to work with borrowers and modify loans. Mr. Colarchik, whose mortgage planning group lends in both California and Nevada, believes that banks are getting smarter about the benefits --to both banks and borrowers-- of negotiating and modifying loans. While the shift has been slow, Mr. Colarchik has recently spoken with clients who are negotiating with banks willing to modify loans to more agreeable terms, even in cases where there is a split in mortgage servicing.

National statistics would seem to confirm the opinions of local experts like Colarchik. Loan modifications and workouts performed under Hope Now Alliance and Bank of America's agreement to restructure loans originated by Countrywide Financial (which it recently acquired) have resulted in more than 3 million American homeowners receiving or expecting to receive more affordable loan terms.

Short sales and deeds in lieu of foreclosure are alternatives to the foreclosure process that can

(continued on page 5...)

“...the number of completed California foreclosure sales for January 2008, 10,556, was a staggering two times the number for the fourth quarter of 2007...”

New California Law Dramatically Affects Residential Foreclosures

(continued from page 4...)

benefit both the borrower and bank or mortgage lender. A short sale is the sale of a property for less than what it is owed by obtaining permission from all the secured creditors to do so. In a short sale, the creditor settles in the full amount owed by the debtor for a value that is less than what the creditor owes. The remaining balance is forgiven. The homeowner no longer owes anything to the creditor. The creditor that authorizes the short sale issues a settlement letter stating that the debt is settled in full for a specified amount.

From a practical standpoint, local real estate professionals warn of the potential drawbacks and limitations of short sales. Buyers must be willing to wait out what can be a long process; banks may have little concern or respect for important contract dates; buyers are buying a property "as is"; buyers are often left with little time to conduct inspections; and the disconnect between in-house foreclosure and in-house short sale departments at banks leads to the potential for short sale deals to fall apart. In other words, according to local professionals like Karen Bruno at Chase International in Incline Village, there is a lot of risk in getting involved in the short sale process.

However, short sales can offer amazing values to buyers willing to take the risks and a short sale can certainly benefit the seller by allowing the seller to get out from underneath a burdensome loan. A licensed real estate agent can help make the process proceed more smoothly.

Another local real estate agent, Shahri Masters of Intero Real Estate Services, paints the

same picture of short sales. In one deal, Ms. Masters' client made a short sale offer which was accepted by the seller. Relying on the seller's acceptance of the offer, the buyer underwent the inspection process only to have the bank, which received a higher offer, reject the offer and sell the property to another buyer. But again, despite these potential pitfalls and risks, short sales can be of great benefit.

Another alternative to going through the foreclosure process is for the borrower to grant the lender a deed in lieu of foreclosure. A deed in lieu of foreclosure is a deed instrument in which a borrower conveys all interest in real property to a lender to satisfy the borrower's loan that is in default and avoid foreclosure proceedings. In order to be considered a deed in lieu of foreclosure, the indebtedness must be secured by the real estate being transferred. Both sides must enter into the transaction voluntarily and in good faith. The settlement agreement must have total consideration that is at least equal to the fair market value of the property being conveyed. Generally, the lender will not proceed with a deed in lieu of foreclosure if the outstanding indebtedness of the borrower exceeds the current fair market value of the property.

The principal advantage to the borrower is that it immediately releases the borrower from most or all of the personal indebtedness associated with the defaulted loan. The borrower also avoids the public nature of a foreclosure proceeding and may receive more generous terms than he or she would in a formal foreclosure. Deeds in lieu of foreclosure also offer advantages to the lender

including a reduction in the time and cost of repossession and additional advantages if the borrower subsequently files for bankruptcy.

Real estate servicing and financing professional Geneva Martinkus, of Allied 1031 Exchange in Reno, Nevada, has seen an upswing in deeds in lieu of foreclosure. However, according to Ms. Martinkus, the trend has been for borrowers to request such an option but lender's to refuse, opting for foreclosure instead. Tax benefits associated with taking the loss from a foreclosure likely lend to banks choosing the foreclosure option over alternatives like those mentioned above.

David Colarchik (dave@tahoelending.com), of Tahoe Lending Group, Inc., is a CPA who has been successfully involved in mortgage lending and private money lending since 2000.

Karen Bruno (kbruno@chaseinternational.com) is a licensed Realtor and buyer specialist with Chase International in Incline Village. Ms. Bruno's background as a litigation paralegal has given her an edge in the area of risk management.

Shahri Masters (masters@inclineliving.com) of Intero Real Estate Services has been a high producing real estate sales agent for over twenty years. Ms. Masters is also well versed in construction and development and coordinating the building permit process with TRPA.

Geneva Martinkus (Geneva@allied1031exchange.com) is the Company President of Allied 1031 Exchange, a national qualified intermediary for 1031 tax deferred exchanges. Ms. Martinkus has over twenty years of real estate service experience. She previously worked at a regional title company, managing and operating the 1031 Exchange department as well as the Installment Collection and Foreclosure departments.

"A deed in lieu of foreclosure is a deed instrument in which a borrower conveys all interest in real property to a lender to satisfy the borrower's loan that is in default and avoid foreclosure proceedings."

Rogers, Wolf, von Baeyer, & Herhusky, LLP
264 Village Blvd., Suite 104
Incline Village, NV 89451

Phone: (775) 831-3666
Fax: (775) 831-4044
E-mail: newsletter@inclineaw.info



Rogers, Wolf, von Baeyer & Herhusky, LLP is a boutique law firm located on the North Shore of Lake Tahoe. The firm, founded in 1973 by John C. Rogers, has earned a reputation for professionalism, discretion, diligence and positive results.

In short, we are personally committed to excellence and to our clients' success.

Our areas of practice include change of residency, creation and management of entities, contracts, real estate, asset protection, family law, commercial transactions, civil litigation and estate planning.

All of our attorneys are licensed in Nevada and California.

A Law Firm Committed to Excellence & Committed to You.



***From left to right:** John C. Rogers, Esq.; Catrina Jenkins; Jamie L. Winter, Esq.; Heidi Shaughnessy; Cassell von Baeyer, Esq.; Stacey F. Herhusky, Esq.; Vicki Munns; Angelina Calafiore; Willow Cornelius; Andrew N. Wolf, Esq.; not pictured: Vera Ann Struc, Esq., of counsel*