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USING THE “SHORT SALE” AS AN ALTERNATIVE TO FORECLOSURE

By J. Wesley Raborn, Attorney

What is a “Short Sale?”

A short sale in real estate happens when a lender accepts less than the total amount that is due on the mortgage. This is sometimes a prudent option for the seller to avoid foreclosure if the lender will allow it. A short sale can only occur with the lender's approval. A short sale typically gets approval before a foreclosure if the lender thinks it will save money by agreeing to the short sale rather than having to go through the foreclosure process. The main benefit of a short sale compared to foreclosure is that the short seller will be eligible for a new mortgage much sooner than a person who goes into foreclosure.

Who can qualify for a short sale?

For a lender to consider a short sale, a seller must meet the following criteria:

1. **The home's value must have dropped below its worth.** This should be substantiated through hard comparable sales.
2. **The mortgage must be in or near default status.** Lenders no longer require the seller to be in default before a short sale will be approved. Lenders now will look at a potential default and may decide to avoid the problem before it gets worse.
3. **The seller must be experiencing financial hardship.** Examples of hardship may include unemployment, divorce, medical emergency, or bankruptcy. A lender will likely not be sympathetic to financial hardship brought on by poor purchasing decisions.
4. **The seller must have no assets.** If a seller has cash, other real estate, stocks, bonds or even IRAs, the lender may not grant the short sale if the seller has ability to pay the shorted difference. If the short sale is granted, the seller may be required to pay the difference.

What are the steps involved in obtaining a short sale?

Here is a basic overview of how to go about arranging a short sale:

1. **Call Your Lender.** The earlier you call the lender the better. Keep in mind that you need to speak with a manager or supervisor who has authority to make decisions regarding short sales. This could take some effort to find the right person.
2. **Submit a Letter of Authorization.** If you are working with an attorney or real estate agent, you need to authorize the lender to work directly with them. Most lenders are not willing to give out any personal information to anyone other than you. Some lenders refuse to allow their employees to speak with attorneys.
3. **Prepare a Preliminary Net Sheet.** This is a statement that shows the amount you expect to receive from the sale of the

property and all the costs of sale including unpaid loan balances, outstanding payments due and late fees, attorney fees, and real estate commissions, if any.

4. **Prepare a Hardship Letter.** This letter describes your financial situation and the reasons why you will not be able to continue paying on your mortgage. Approval of a short sale is made by a human, not a computer, so the more sympathetic and accurate the letter, the better your chances.
5. **Obtain Proof of Income and Assets.** Lenders will want to know what your income is and whether or not you have assets that could be sold to help pay your obligation. You want to use this documentation to prove that you do not have the ability to pay the mortgage, making the approval decision easier for the lender. Be accurate as your credibility is at stake with the bank.
6. **Provide Copies of Bank Statements.** Any large deposits or withdrawals will need to be explained. Also, frivolous expenses such as frequent shopping trips or a recent car purchase will also hurt your chances of approval.
7. **Obtain a Comparative Market Analysis.** A CMA will allow you to substantiate your claim that the value of your home has fallen. A real estate agent or appraiser can prepare this for you.
8. **Provide a Copy of the Purchase Agreement and HUD-1.** When you reach an agreement to sell your home to a third party, your lender will want a copy of the Purchase Agreement before it approves the short sale. Make sure your realtor uses the “short sale” form and conditions acceptance on the lender agreeing to the short sale and/or release of all or part of the deficiency. The lender may want to get involved or renegotiate certain terms such as realtor commissions and inspections of the property. Oftentimes a buyer may be willing to pay more if they can still get the home in a short sale.

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USING THE “SHORT SALE,” continued

What are the risks involved with a short sale?

1. **Tax Consequences.** A seller may be required to pay income tax on the amount of the loan that is forgiven by the lender. However, the Mortgage Forgiveness Debt Relief Act of 2007 generally allows a seller to be exempt from paying tax on debt cancellation income on his principle residence, or in the instance of foreclosure, bankruptcy, or insolvency. See IRC § 108. This law is in effect for the 2007 through 2012 calendar years. See IRS Publication 4681.

2. **Credit Score.** A short sale will adversely affect a seller’s credit score. Experts agree that the damage done to the FICO score is nearly identical to the damage done by foreclosure, around 200-300 points. The good

news for shorts sellers is that they should be able to purchase a new home with a reasonable interest rate within about 24 months, whereas a buyer with a foreclosure on his record may not be able to get into a new mortgage for up to 5 years.

3. **Deficiency Judgment.** The lender has discretion to pursue the amount of the loan it is “shorted” as a result of a short sale through a deficiency judgment. Whether the lender will agree to release you from the deficiency or work out a reasonable payment plan of a portion of the deficiency amount should be discussed early with the lender and your realtor.

THE “PERSONAL PLEASURE” DEFENSE

By John C. Young, Attorney

In the “no fault” world of workers’ compensation, it may seem as though any injury in the workplace will qualify for benefits. Although the material contributing cause standard may be low for workplace accidents, injuries that arise out of social or recreational activities may be denied under a personal pleasure defense.

In *Washington Group Int’l v. Barela*, 218 Or App 541 (2008), the employee ruptured his Achilles tendon during an unpaid lunch break as he assisted in shaking a vending machine to set free a lodged candy bar. The insurer denied the claim on the grounds that the employee’s actions were social and that the activity did not arise out of or during the course of his employment. The Workers’ Compensation Board overturned the denial but on appeal, the employer successfully argued that the Board applied the wrong analysis and remanded the case for further review.

ORS 656.005(7)(b)(B) excludes from coverage any “injury incurred while engaging in . . . any recreational or social activities primarily for the worker’s personal pleasure.” In *Barela*, the Court of Appeals reiterated the three-step test for determining if a worker’s activities are for personal pleasure. The first question is whether the worker was engaged in a recreational or social activity. The next question is whether the injury was incurred while engaging in that activity. Lastly, ask whether the recreational or social activity was engaged in by the worker primarily for personal pleasure. An answer of yes to each question means that the worker cannot recover for an injury resulting from a personal pleasure activity within the meaning of ORS 656.005(7)(b)(B). See, *Roberts v. SAIF*, 341 Or 48 (2006); see also, Pamela S. Langley, 60 Van Natta 1098 (2008) (worker’s claim was denied under the Roberts analysis after she injured her wrist at work playing a form of the game Jenga using cardboard boxes).

NEW REPORTING REQUIREMENTS FOR IRREVOCABLE TRUSTS

By Theresa M. Wade, Attorney

In 2006, the Oregon Legislature completely revised the statutes regulating the administration of irrevocable trusts, replacing the prior language with a new “Oregon Uniform Trust Code” at ORS Chapter 130. Effective January 1, 2007, all trustees of trusts that were irrevocable on that date, or that became irrevocable following that date, were required to prepare a report to the beneficiaries of the trust, reflecting the activities of the trust during 2007 and for each year thereafter. This report must be provided to the trustor (also referred to as the settlor or the creator of the trust) and to all qualified beneficiaries of the trust (which include income beneficiaries, remainder beneficiaries and contingent beneficiaries). The legislative intent in adopting this requirement was to protect those ultimate beneficiaries of a trust and provide them with information on the activities of the trustee and the funds remaining in the trust, on an annual

basis. Prior to these changes in Oregon law, those ultimate beneficiaries had no legal standing to demand an accounting until they became entitled to distributions from the trust, which may have been too late to correct any problems or inappropriate distributions made in prior years.

A trust becomes irrevocable upon the incapacity or death of the creator of the trust, or may be irrevocable at the time the trust was created, depending on the intent of the creator of the trust and the documentation used to establish the trust.

If you have questions about your own trust, or would like to discuss ways in which these reporting requirements can be modified or waived, please contact Ms. Wade at 503.581.1501 or twade@ghrlawyers.com.

COMMERCIAL EVICTIONS 101

By J. Wesley Raborn, Attorney

A sign of the current economic times is the increase in commercial landlord-tenant disputes, generally over the non-payment of rent. Under Oregon law, the vehicle used by landlords to evict tenants is the forcible entry and detainer action ("FED"). FED is a summary process in which the only issue before the court is the right to possess the leased premises. Any claim for damages is reserved for a separate civil suit. No counterclaims are allowed unless provided by statute. The purpose of this article is to provide landlords with an understanding of what to expect and how to improve the landlord's chance of success in an eviction action.

A Landlord's Claim is Only as Good as the Lease

The most expensive cases are the ones where landlords engaged non-lawyers or used a form agreement off the internet for their lease. Each property and each tenant are vastly different, so each lease should be carefully drafted. The lease document governs the landlord-tenant relationship, who pays what costs, and what constitutes a default. Landlords should make sure that the lease provides the landlord with a right to evict a tenant through the FED. Surprisingly, some leases have mandatory mediation or arbitration with no special provision allowing the FED process in certain instances.

Construction Work on the Leased Premises

If it is a ground lease or a lease with tenant improvements, a landlord should file notice of non-responsibility in the real property records and post the same on the leased premises during the planned construction. The lease should provide for prior written notice to the landlord for any construction work on the premises. Otherwise, in addition to the eviction lawsuit, the landlord could be saddled with a defunct tenant and defending contractor lien foreclosure suits.

Notice

Landlords cannot take any action to evict without prior notice to the tenant. Oregon law has mandatory time periods for notice, but the lease may provide for different time periods. Read the lease on how you are to notice the tenant for any default or right to cure letter. Although first-class mail may be all that is required under the lease, certified mail, return receipt requested may be appropriate. The worst thing a landlord can do is waive a tenant default by routinely allowing a breach to occur without issuing a notice of default, and then at a later date attempt to evict based on that same or similar breach. Any notice you send the tenant will be evidenced in the FED action or civil suit. It's important the notice is clear, offers the tenant a reasonable cure option, and is contractually and statutorily correct. Always cite to the lease paragraph for each breach.

Engage Your Tenant Early and Often

If your commercial tenant's payments are late, contact the tenant immediately. Provide the mandatory notice of default to the tenant as set forth in the lease. Chances are the tenant will blame nonpayment on the economy. If the tenant has been a long-time tenant or one with good prospects, consider a work-out plan with the tenant to help them "bridge the gap" of hard times. Taking a scorched earth approach to late payments of rent may result in the landlord winning the battle in the FED action, but losing the war in that the landlord now has a commercial space that may sit non-producing for years. Commercial spaces are plentiful right now.

A sit down with the tenant and their certified public accountant may produce better overall benefits to the landlord than an eviction. It may help the landlord forecast whether it is worth reducing rent in the short term in order to keep a potential good producing and long-term client. In the end, charging a financially distressed tenant \$8,000 a month for rent for 2 more months and then having to file the FED action may be more harmful than charging the tenant \$4,500 per month for a year, with a future repayment obligation with some security. Eviction will be your only option if the tenant is new or has been routinely late with payments, or if you are tied to your lender's demands.

Work Out Agreement

If you can come to some temporary agreement with the tenant for deferred payment or a time to cure period, document the agreement with a written document signed by tenant. The written agreement should provide that in consideration of the work out agreement, the tenant releases all claims against the landlord under the lease, any claims as to any future lockout, and a representation that tenant agrees they are in breach, and that tenant agrees to landlord's accounting of the breach. This written agreement will save you time and money in any later eviction action on proving breach and defending any tenant claims.

Landlord Liens vs. Self-help

Landlord liens generally have priority over other liens on the equipment on the leased premises, except tax liens and perfected financing statements on the equipment before the equipment was brought onto the leased premises. ORS 87.146 and 87.162. A landlord lien is often times confused with self-help. A landlord lien only requires that the property be owned by the tenant, is on the tenant's premises and the landlord provide notice to the tenant asserting the landlord lien (and a claim of conversion if they remove it after the notice). Landlord liens do not prevent the tenant from removing the property, but if the proper notice is given, the landlord will have a claim for conversion. A landlord should run a UCC search on tax and other liens on the tenant's personal property for purposes of priority. Landlords need to be aware that some tenants purchase equipment under other names, and thus a UCC search may not help the landlord find all encumbrances on the tenant's personal property. A lease provision forbidding tenant to acquire equipment or engage in activity related to the leased premise may help deter such activity.

If the landlord does assert the landlord lien and takes possession of the property, there are detailed and mandatory statutory notices and advertising the landlord must make before the landlord forecloses

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ANNUAL LIMITS INCREASE FOR GIFTING

By Theresa M. Wade, Attorney

Effective January 1, 2009, an individual may transfer assets (such as cash, business interests, property, and personal property) to other individuals, without paying gift tax or reporting those transfers, in an amount up to \$13,000 per recipient. That amount increased over the 2008 level of \$12,000. A married couple may combine their gifting and transfer a total of \$26,000 to each recipient, even though all or part of the \$26,000 gift came from one or the other of the spouses. The recipients of these gifts do not report this as income, and a gift tax return is not required (although it may be helpful to file, at your tax preparer's recommendation). This amount is known as the "annual exclusion from gift tax." **If you have questions about the use of the annual exclusion, or the ways in which these annual gifts may leverage the transfer of assets to the next generation, please contact Ms. Wade at 503.581.1501 or twade@ghrlawyers.com.**

COMMERCIAL EVICTIONS 101, continued

or sells the property at commercial sale, which will include any claim for storage costs.

Self-help is the actual lock out of the tenant from the premises or taking tenant property from the premises in order to secure some form of collateral for a payment default. In Self-help, it is imperative that the landlord follow the proper procedures, as the tenant may have a counterclaim for damages, including interference with business operations if there is an ongoing enterprise on the leased premises at the time. Also, the landlord may take property that does not belong to the named tenant under the lease. Self-help is an extraordinary remedy that should be reserved for limited cases where the landlord believes the tenant is financially distressed and is going to remove the equipment from the leased premises.

The FED Action

An eviction is a summary process. Unlike civil litigation which can take over a year to get to trial, FED actions provide for a first hearing the week following the filing of the claim for possession. At the first hearing, you can expect the judge to provide the parties with two options, mediation or trial. The mediation route is generally for landlords who would like to give the tenant one more shot at working their difference out or for the parties to stipulate to a walk out date and the terms of the walk out. If mediation is the route, then the judge will enter a stipulated order that will govern the parties' rights for a number of months, which if breached, the landlord has the option to terminate the lease based on the breach.

The landlord is under no obligation to mediate. If the offer is declined, the judge will set a trial date for the following week. There is no discovery, unless the parties agree to do so which is generally not the case. At trial, the landlord will have the burden of proof on the reasons for eviction. The reasons for eviction not only have to be well documented, but they must be important (like non-payment of rent for some time, substantial use violations, damage to the premises). Although counterclaims are generally not allowed, the landlord can expect affirmative defenses (lack of notice, waiver of certain lease terms, estoppels).

Litigation comes at a price and results are uncertain. If the lease provides, the prevailing party would be able to recover attorney fees and costs. However, if the landlord has a tenant not paying rent, expect a tenant who does not pay your judgment for fees.

Document, Document, Document

The landlord will generally have the burden of proof both in the FED action for possession and any subsequent civil suit for damages. Nothing convinces a judge more than detailed documentation and accurate and timely notice to the tenant of any breach for which the landlord will seek reimbursement.

Landlords should not only take photographs or video of the leased premises just before the tenant takes possession, but should also do so on the day the tenant moves out, or during a requested inspection under the lease. If the tenant has been evicted or has abandoned the premises, the landlord should take a detailed accounting of all equipment, inventory and materials left on the premises and the condition of the premises. The landlord should have a properly licensed expert remove any fixtures or equipment that need to be stored so as to avoid a claim of damage by the tenant. If the landlord has stored any abandoned property, then the landlord must send the tenant detailed notice of what is being stored and the costs associated with storage. If the landlord has to hire a third-party to clean or repair, the landlord should provide the tenant with prior notice under the lease.

Conclusion

Nothing prevents the landlord from engaging in a reasonable dialogue with the tenant, while at the same time providing the tenant with the notices to cure and inspection in preparation for filing the eviction action. If anything, the landlord has much more to gain by discussing issues with the tenant as the landlord not only gets to gauge the tenant's financial condition and affirmative defenses, but the landlord will gain credibility with the judge if it is shown that the landlord tried to make the relationship work prior to filing the eviction.