



## Dramatic Changes Proposed to Lease Accounting Rules: Bad News for the Real Estate Industry?

By Mia Weber Tindle

### INTRODUCTION

The U.S. Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) are embarked on a joint project to overhaul lease accounting standards. The stated goal is to address a perceived lack of transparency and undue complexity under current standards and eliminate the current bright-line distinction between an operating lease and a capital lease. In continued post-Enron fallout, the project is another in a long litany of standards meant to address the boards' concerns regarding off-balance sheet arrangements that may not reveal to a user of financial statements a company's true financial obligations. The boards' fundamental premise, as stated in their project objectives, is that leasing is an important source of finance, and therefore, should be faithfully reflected as assets and liabilities on the balance sheet.

After several years of preparation, in August 2010 the FASB and the IASB issued an *Exposure Draft* (ED) outlining the proposed changes. Under the ED, the long-standing distinction between operating leases and capital leases will no longer exist. Any arrangement falling within the proposed broad definition of a "lease" must be reported on the balance sheet with very limited exceptions. The proposed

changes represent a major alteration of the current lease accounting model and are anticipated to have consequences to nearly every organization. According to the U.S. Securities and Exchange Commission (SEC), \$1.3 trillion will be placed on the balance sheet by public companies alone, and PricewaterhouseCoopers estimates reported debt load will increase by 57 percent on average.

If the proposed changes are implemented, the apparent anomaly of an airline carrier operating a fleet of aircraft under equipment leases, with none of the aircraft reflected as assets or liabilities of the carrier on its balance sheet, would be eliminated. However, in the quest for transparency, the boards may be overreaching in the arena of leases of real property. Treatment of real property leases as financing arrangements that must be reported on the balance sheet (unlike other executory contracts such as long-term sales and supply agreements) may not accurately reflect the nature of the parties' obligations, particularly when attempting to comply with the more controversial elements of the ED described below. The rules are anticipated to have dramatic impacts not only on the financial statements of users and owners of real estate, but quite possibly on the real estate market as a whole.

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## Residential Mortgage Foreclosure— Judicial Scrutiny and the State of the Market

By Richard S. Fries, Todd B. Marcus and Brian A. Katz

Today's residential mortgage lender faces unprecedented enforcement challenges. This article examines some of the more serious legal issues mortgage lenders are facing and offers some practical solutions for overcoming these obstacles.

### LOAN DOCUMENTATION AND CHAIN OF TITLE DEFECTS

Recently, the issue of standing has taken center stage in residential foreclosure proceedings. This issue drew national attention earlier this year when the Massachusetts Supreme Judicial Court issued its decision in *U.S. Bank National Association v. Ibanez* (and the related case of *Wells Fargo Bank v. LaRace*), 458 Mass. 637.

In *Ibanez*, the Massachusetts Supreme Judicial Court (the highest court in Massachusetts) upheld the decision of the Massachusetts Land Court invalidating two foreclosure sales because the foreclosing trustees were not the holders of the mortgages at the time they initiated foreclosure proceedings. The Massachusetts Supreme Judicial Court held that ownership of the mortgage must be established at the time foreclosure proceedings are commenced. According to the court, after-the-fact assignments could not be used to cure this defect and the foreclosure trustees thus lacked "standing to sue."

In *Ibanez*, Wells Fargo and U.S. Bank, acting for the foreclosing securitization trustees, argued that in addition to receiving assignments in blank, the pooling and servicing agreements assigned the mortgages to the securitization trusts. The court, however, rejected those arguments, finding that an assignment "in blank" is void and does not evidence a conveyance of the mortgage. The court went on to find that poolwide assignments of "all right, title and interest" in the mortgages contained in the trust agreements also were ineffective because there was no proof that the mortgages were included in any schedules attached as exhibits to those agreements.

One could take issue as to whether *Ibanez* was correctly decided. While the court relied on a case from 1889, the court, significantly, failed to mention Section 9-203(g) of the Massachusetts Uniform Commercial Code. This statute provides that attachment of a security interest in a promissory

note is also attachment of a security interest in a mortgage that secures the promissory note (i.e., the mortgage "follows," or travels with, the note).

Additionally, the decision did not consider the well-established legal principle of ratification. Under this doctrine, a borrower who has accepted and utilized the proceeds of a mortgage loan (usually for the purchase of the mortgaged premises), received monthly statements and made consistent, and regular monthly debt service payments on account thereof, essentially is estopped from denying his obligation to repay the loan in accordance with its terms.

This does not mean that the lenders should necessarily have prevailed in *Ibanez*, though. Even if the court had held that the mortgage did follow the note in Massachusetts, the lenders would still have had to prove that they owned the notes. It is possible that the same obstacles that the lenders faced in proving ownership of the mortgages would have confronted them in proving ownership of the notes.

Whether or not *Ibanez* was correctly decided, the decision provides a valuable lesson to mortgage lenders, and their lawyers, contemplating foreclosure. Lenders would be well advised to take certain initial steps to establish that they own and hold both the indebtedness (the promissory note) and the security (the mortgage). In this way, lenders can minimize the risk (including the possible dismissal of the foreclosure action) on the critical issue of their standing to sue.

The initial steps should include the following:

The collateral file should be reviewed to make sure it contains (i) an endorsed note either endorsed in blank or to the lender, with all necessary endorsements completed by authorized officers of the assigning entity, and executed and (ii) notarized assignments of mortgage to the lender. If the assignment of mortgage was executed in blank, the lender's name must be inserted in order to make the assignment effective. Additionally, the assignment and transfer documents should be reviewed to make sure the subject note and mortgage in fact were sold or transferred to the foreclosing lender. An even better practice is to make sure a proper assignment is recorded at (or before) the time the lender declares a default and accelerates the mortgage loan (long before the commencement of any foreclosure action).

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# What Do the New 2011 ALTA/ACSM Survey Standards Mean to Owners and Lenders?

By Frank A. Appicelli

## BACKGROUND

On Feb. 23, 2011, the “2011 Minimum Standard Detail Requirements for ALTA/ACSM Land Title Surveys” went into effect and replace the 2005 Standards. The 2011 Standards were adopted by the American Land Title Association (ALTA) and the National Society of Professional Surveyors (NSPS) in the fall of 2010. The 2011 Standards have been described as the first major rewrite of the Standards since their initial adoption in 1962. Since an ALTA/ACSM survey is a standard closing requirement for a commercial real estate transaction, owners and lenders will want to know what the 2011 Standards mean to them.

The 2011 Standards are the result of two years of work by NSPS and a select group of title attorneys from ALTA. However, most owners and lenders were probably not aware of this project. One understandable reaction will be a concern that the drafters of the 2011 Standards, primarily surveyors, have intentionally or unintentionally weakened the benefits of the ALTA/ACSM survey to owners and lenders. Generally speaking, there has not been any significant weakening of the benefits of the ALTA/ACSM survey from the perspective of an owner or lender. Nonetheless, owners and lenders need to be aware of the changes in the 2011 Standards.

## SUMMARY OF CHANGES

The depiction of the property and the plottable title matters shown on a survey prepared under the 2011 Standards will differ very little from a survey prepared under the 2005 Standards. In large part, the differences between the 2011 Standards and the 2005 Standards are formatting revisions to the organization of the Standards and the streamlining of terminology for consistency purposes. Other differences are technical in nature and are largely refinements in the measurement standards to be used by surveyors that should not materially affect owners or lenders. The following is a listing of differences between the 2011 Standards and the 2005 Standards that may be of concern to owners and lenders:

**1. Exclusive Form of Surveyor’s Certification:** The 2011 Standards contain a “short-form” surveyor’s certification that is generally the same as the one contained in the 2005 Standards. However, the 2005 Standards described this certification as one that could be made when the

surveyor had met all of the detail requirements of the 2005 Standards. This was generally interpreted as permitting changes and additions to this form of certification. In fact, most owners and nearly all lenders require their own version of a “long-form” certification from surveyors. This is no longer allowed under the 2011 Standards. The 2011 Standards state that “[t]he plat or map of an ALTA/ACSM Land Title Survey shall bear only the following certification, unaltered, except as may be required under [applicable laws].” This is the one change in the 2011 Standards that appears to be an intentional effort by the surveying industry to avoid complying with the long-form survey certification requirements imposed by owners and lenders. However, as discussed below, owners and lenders that take a hard look at their “long-form” certifications will likely find that the short-form certification provides adequate assurances as to the scope and standards of the survey.

**2. Recognition of Lenders:** The 2005 Standards did not include any references to lenders within the purposes of the surveying standards. The 2005 Standards only implicitly recognized lenders as part of the surveying process by referring to lenders as a potential party who could be named within the short-form surveyor certification. The 2011 Standards now expressly recognize lenders as parties who have come to rely on complete and accurate surveying work.

**3. Mandatory Depiction of Table A Items:** The Table A appearing at the end of the 2005 Standards also appears in the 2011 Standards. The Table A items are described as optional survey responsibilities and specifications to be negotiated with the surveyor. In the 2011 Standards certain of these optional items have become mandatory items and have been moved out of Table A and into the main body of 2011 Standards. These new mandatory items are (a) the vicinity map showing the surveyed property in reference to nearby highways and major streets and (b) the indication of access to public ways such as curb cuts and driveways. For owners and lenders who already required these items when they were optional under the 2005 Standards, this will not constitute a noticeable change.

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## Private Transfer Fees: A Growing Trend Meets Stiff Opposition

By Lauren R. Goodman

Consider a private developer placing a recorded restriction on certain real property it has recently developed. The restriction provides that each time the property is sold during the next 99 years, the seller must pay a one percent fee to the original developer. These restrictions, known as private transfer fees, have become increasingly common throughout the United States. In fact, according to the American Land Title Association (ALTA), private transfer fees currently affect an estimated \$520 billion worth of real estate. However, these fees have also faced strong resistance from state legislatures as well as influential groups such as ALTA and the National Association of Realtors (NAR).

The example above describes a transfer fee that is payable to a private developer and does not necessarily relate to benefits being provided to the property itself or the surrounding land. By contrast, there are two other types of transfer fees that do relate to the property or the surrounding land.

The first is a fee imposed by a homeowner's association, whereby the homeowner's association assesses a fee in exchange for services it provides to homeowners such as recreational facilities and other community benefits. The second is a fee payable to a non-profit organization to fund its activities that relate to the transferred property or the surrounding area, which may include, for example, ameliorative environmental efforts or initiatives to provide affordable housing. Homeowner's association fees and non-profit organization fees differ from a purely private transfer fee in that they provide a clear benefit to those obligated to pay the fee. This factor has distinguished private transfer fees as more controversial under the two approaches most commonly utilized to analyze the legality of a transfer fee.

Rooted in common law, the traditional approach to evaluating whether a covenant would "run with the land" and therefore bind successors in interest to the property was the "touch and concern" standard, which requires that the covenant is closely related to the use of the land. Under this approach, to establish the legality of a restrictive covenant, it is significant to establish that both the benefit and the burden of such restriction touches and concerns the land. The benefit of private transfer fees, as opposed to fees payable to homeowner's associations or non-profit organizations, is personal to those that imposed the fee rather than to those who are also burdened. In applying the touch and concern standard, courts have frequently held that the payment of

money pursuant to a private transfer restrictive covenant was a benefit that ran solely to the developer without providing any benefit to the property owners or subsequent purchasers of the same property, and therefore invalidated private transfer fees.

Explicitly abandoning the touch and concern standard, the more modern approach advocated by the American Law Institute's Restatement (Third) of Property ("Third Restatement"), which was published in 2000, proposes a general rule that a covenant will be binding upon successors in interest to property unless "it is illegal or unconstitutional or violates public policy." It then narrows this rule, providing that a covenant that would violate public policy is "arbitrary, spiteful or capricious," an unreasonable burden on a "fundamental constitutional right," "an unreasonable restraint on alienation," "an unreasonable restraint on trade or competition," or "unconscionable." Highlighting the departure from the touch and concern standard, the Third Restatement approach has been interpreted to mean that a restrictive covenant that imposes an indirect restraint on alienability, such as a private transfer fee, is valid unless it lacks a "rational justification." Under this broader approach, courts are thought to have greater flexibility to validate private transfer fees. The American Law Institute, an organization composed of eminent lawyers, judges and legal scholars, is dedicated to the improvement of the law. Its restatements have considerable influence on appellate courts and, by rejecting the more stringent touch and concern requirement, the adoption of the Third Restatement approach has prompted the proliferation of private transfer fees in many states.

Developers who impose private transfer fees have several arguments in favor of upholding the imposition of these fees on subsequent transferees of the restricted property. First, and perhaps most obvious, private transfer fees allow developers to sell property at a lower price today in exchange for a monetary benefit in the future in the form of transfer fees. Second, assuming that the covenant is recorded in the land records where the property is located, potential buyers have notice that such a covenant exists and can adjust their offer price for the property accordingly. In this regard, developers take the position that private transfer fees allow buyers to negotiate lower prices to acquire restricted property than to acquire comparable unrestricted property. Finally, whether or not these justifications are persuasive, developers

LEASE ACCOUNTING RULES, CONTINUED FROM PAGE 1

## PROPOSED APPROACHES: LESSEES AND LESSORS

Under the ED, there are differing proposed approaches for lessee accounting and for lessor accounting. For lessee accounting, the tenant would employ a “right-of-use” model, booking the use of the realty as an asset and the rental obligations over the life of the lease as a liability. The asset is measured initially at cost, which is calculated as the amount of the liability and any initial direct costs incurred. Subsequent measurement is amortized over the shorter of the lease term or the economic life of the leased assets and subject to impairment (*i.e.*, where the carrying amount of a long-lived asset exceeds its fair value or recoverable amount). The liability is initially measured at the present value of the lease payments, discounted using the lessee’s incremental borrowing rate (or the rate the lessor charges the lessee, if readily determined). The tenant is required to reassess each reporting period if facts or circumstances indicate there would be a significant change.

For lessor accounting, there are two differing proposed models: either a “performance obligation” approach or a “derecognition” approach, depending upon whether or not the landlord retains significant risks or benefits with respect to the property. Under the performance obligation model, the leased asset remains on the balance sheet and is depreciated, and a lease liability is recognized. Under the derecognition approach, the leased asset is “derecognized” for the portion representing the lessee’s right of use, and there is no lease liability recognized. There is a great deal of debate amongst commentators as to which approach to lessor accounting is appropriate, and many in the real estate industry believe that neither is. Many commentators have also noted there is a gap between the ED and current international standards. Under IAS 40 (a standard promulgated by the IASB) there is an exclusion for investment property held for fair value. Although the FASB is pursuing a project on this topic, no proposed rule has yet been published, and some have requested that the boards delay a final decision on lessor accounting until that project is complete.

## OPTIONS TO EXTEND AND CONTINGENT RENTALS

Several elements of the ED have garnered a great deal of commentary and objection across the spectrum of stakeholder views. One of these is the treatment of options to extend the lease term. The ED calls for the inclusion of any lease option term that is “more likely than not” to occur. This determination would be required in each reporting period. Thus, two similarly

situated lease parties with identical lease provisions could reach very different reported outcomes, each rationally based, on their respective financials. Some question the speculative nature of determining whether an option is more likely than not to be exercised as potentially creating greater confusion rather than greater clarity.

Many commentators are also concerned about the proposed treatment of contingent rentals under the ED, such as percentage rent or increases tied to the Consumer Price Index. The ED would require a party to estimate and include any contingent rental amounts over the life of the lease. As an example, it is very common for a retail lease to contain a percentage rent clause, calculated as a percentage of the tenant’s gross sales at the location above a specified minimum. Therefore, a tenant with a ten-year lease would be required to estimate its gross sales at that particular location over the full ten-year period. Such estimations seem contrary to the boards’ express goal of creating clarity and accuracy in financial statements.

## HOW WILL THE CHANGES AFFECT USERS, OWNERS AND LENDERS?

The proposed accounting under the ED will produce dramatic impacts on company financial statements, with the capitalization of leases based on the present value of estimated net lease payments over the expected lease term that is “more likely than not to occur,” discounted at the lessee’s incremental borrowing rate. Because the ED calls for rent to no longer be calculated on a straight-line basis as in the current model, total occupancy expense would be much higher and front-loaded over the first half of the lease. This is anticipated to lead to a continuously front-loaded expense profile, a greater reported cash flow and higher reported capital spending.

Users of property will be forced to analyze and reevaluate the impacts of their lease obligations on a continuous basis. Companies with a reliance on real estate to generate revenue, such as retailers and those with large customer service operations, will be disproportionately impacted. Because the revised calculation of lease obligations may result in a breach of existing loan agreement debt covenants, companies will likely need to approach lenders to renegotiate terms. Lenders, conversely, will need to be prepared for these requests, and will need to make sure their loan documentation builds in appropriate flexibility to anticipate the changing debt ratios created under the proposed new rules. The

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## LEASE ACCOUNTING RULES, CONTINUED FROM PAGE 5

administrative burden will be enormous, since systems will need to be developed to analyze and calculate the obligations as called for under the ED.

Owners and investors of real property can expect a shift by tenants away from many elements currently contained within commercial leases, such as options to extend and contingent rent clauses. More dramatically, the changes are expected to shift some users towards shorter lease terms, impacting the ability to finance projects, or in some instances towards ownership of realty rather than leasing.

### A GLIMMER OF HOPE AHEAD?

The public comment period to the ED closed on December 15, 2010, with the FASB/IASB originally planning to adopt final rules by June 2011. The length of the implementation period has not yet been announced. As of April 2011, over 780 comment letters from stakeholders, including Fortune 500 companies, accounting firms and other consultant groups; owners, investors and developers; banks and other lenders; and trade organizations such as NAIOP and NCREIF, were received by the boards. Strong opposition has been voiced by the real estate industry, particularly to the more controversial elements of the proposal relating to lessor accounting, the inclusion of options and contingent rents, and the treatment of service components under a lease.<sup>1</sup> Additionally, over this past winter, the boards conducted a series of public roundtables in various cities, allowing stakeholders to engage in live dialogue with select board members and staff to articulate noted problematic areas and suggestions for revision.

In response to some of the criticism and comments received at their February and March 2011 meetings, the boards pared

back certain of the more controversial elements of the ED. The boards tentatively decided that options to extend the term would be included if “there is a significant economic incentive” to exercise the option, rather than the “more likely than not” standard expressed under the ED. The boards also tentatively decided that contingent rentals would be included where they meet “a high recognition threshold (such as reasonably certain)” thus reducing to a degree the speculative nature of proposed rules under the ED. Most promising, the boards tentatively decided to identify a principle for identifying two types of leases: a “finance lease” with a profit or loss recognition pattern consistent with the ED, and an “other-than-finance lease” with a profit or loss recognition pattern consistent with an operating lease under existing rules. While creating a category for an “other-than-finance lease” would not eliminate the anticipated requirement to capitalize lease obligations and reflect them on the balance sheet, a straight-line calculation (akin to operating lease treatment) would reduce the front-loaded expense profile resulting from treatment contemplated under the ED. The boards directed staff to use the tentative decisions to perform targeted further outreach. If the boards ultimately adopt these variations from the initial ED, it will represent a significant paring back from the elements most objectionable to the real estate industry.

In a significant concession and perhaps in acknowledgement of the complexity and far-reaching implications of the proposed changes, the boards in April extended the targeted date for adoption of a final standard from June 2011 to a more generic “in 2011.” Even with this extended time frame, whether they will be able to resolve the outstanding issues and concerns during this calendar year remains to be seen. <

<sup>1</sup> The comment letters are available on the Leases Project web page of the FASB. See [here](#).

## RESIDENTIAL MORTGAGE FORECLOSURE, CONTINUED FROM PAGE 2

In the event there are gaps in the chain of title that cannot be filled in by calling on prior owners of the note and mortgage to execute proper endorsements and assignments, or if documentation is missing or incomplete (such as lost notes, notes with missing endorsements, or assignments missing in the chain of title), lenders might consider negotiating with their borrowers a short term forbearance agreement in which—in exchange for forbearance or other concessions—these potential problems can be cured and/or corrected.

In a short-term forbearance (on the order of two to three months), the lender can secure, in exchange for its forbearance, an acknowledgement by the borrower of the precise amount of the mortgage debt, and that such amount is due to the lender without any defense, offset or claim. The lender also can obtain the borrower's admission that the lender, in fact, is the owner and holder of the note and mortgage. The lender also could require the borrower to execute a restated or replacement note and mortgage to cure any defects in the chain of title.

These admissions may prove extremely valuable if and when the lender ultimately seeks to exercise its contractual and legal remedies, including foreclosure. As *Ibanez* and other cases suggest, lenders may find an ounce of prevention really is worth a pound of cure.

### PERSONAL KNOWLEDGE (“ROBO-SIGNING”)

Another issue that has gained national attention involves the foreclosing lender's submission of affidavits in which the affiant lacks personal knowledge of the facts contained therein. These facts may relate to the ownership of the loan, the facts establishing the right to foreclose (such as the borrower's default, the service of default and acceleration notices, and the borrower's failure to cure its defaults or make the payments required under the mortgage loan), or the computation of the indebtedness.

Perhaps the most high-profile example of these practices came to light when the representative of a lender testified in a deposition of his practice of executing hundreds of affidavits a day without reading them. This practice, dubbed “robo-signing,” has created a morass of paperwork problems and forced lenders, and counsel, to re-examine the circumstances under which foreclosure-related documentation is prepared and executed. In response to allegations of robo-signing, lenders have voluntarily discontinued hundreds of foreclosure actions, without prejudice to a subsequent re-filing.

Notably, judicial reaction to allegations of robo-signing remains stern notwithstanding lenders' efforts to take remedial actions with respect to affidavits that may have been the product of these disfavored practices. Indeed, one judge imposed monetary sanctions against a lender for submitting an affidavit submitted without personal knowledge, even though the lender had voluntarily discontinued the foreclosure action in the face of such evidence. Further, another judge was not persuaded by the lender's submission of a revised affidavit of indebtedness in light of its acknowledgement that the prior affidavit might not have been executed on personal knowledge or in the presence of a notary.

The foregoing illustrations are emblematic of the difficulties lenders face in attempting to overcome affidavits executed without personal knowledge. In effect, the fallout from robo-signed affidavits threatens to linger beyond the operative life of the document in question.

Ultimately, the issue of robo-signing (and “robo-verifying”) has led to greater judicial scrutiny of foreclosure documents and reminds lenders to place a newfound premium on the preparation and execution of these sworn affidavits. In that regard, foreclosing parties would be wise to implement systematic controls and checks to ensure that affiants are executing affidavits with personal knowledge of the facts and circumstances giving rise to the foreclosure action. Such actions should include a complete review of the business records and loan-related documentation to which such affidavits typically refer and upon which the foreclosure action is based.

In addition, lenders may adopt the use of “standard” forms for certain affidavits (such as affidavits of indebtedness) and checklists to ensure affiants and counsel have taken certain minimum steps prior to the execution of any affidavit to confirm personal knowledge of the underlying facts. Numerous states have recently enacted additional foreclosure documentation and certification requirements to safeguard against robo-signing. The consequences of submitting affidavits where the affiant lacks personal knowledge range from judicial sanctions and findings of contempt of court to the dismissal with prejudice of the foreclosure action (and cancellation of the indebtedness and mortgage lien).

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RESIDENTIAL MORTGAGE FORECLOSURE, CONTINUED FROM PAGE 7

## NEW YORK'S ATTORNEY AFFIRMATION

In response to growing concerns over the accuracy and sufficiency of documents filed in foreclosure cases, in October 2010, the New York state court system added a new prerequisite in foreclosure actions, requiring the attorney for the foreclosing mortgagee to file an affirmation certifying that the attorney has taken reasonable steps to verify the accuracy of the papers filed in the action.

Now, in New York, the attorney for the foreclosing plaintiff must certify, under penalty of perjury, that he communicated with a representative of the plaintiff (identified by name and title) who informed the attorney that the representative (i) personally reviewed plaintiff's documents and records relating to the case (ii) reviewed the summons and complaint, and all other papers filed in the action in support of foreclosure and (iii) confirmed the factual accuracy of the court filings and the accuracy of the notarizations contained therein.

The attorney also must certify, based on his communications with the plaintiff's representative, as well as his own inspection of the papers filed with the court and "other diligent inquiry," that the summons and complaint and all other documents filed in the foreclosure action are complete and accurate "in all relevant respects." The rule applies to all new and pending foreclosure actions.

The adoption of this rule immediately ground to a halt all pending foreclosure actions in New York and stemmed the flow of new foreclosure actions, while plaintiffs' attorneys grappled with its consequences. Now, many plaintiffs' attorneys are requiring their clients to execute and deliver sworn declarations attesting to the client's personal review of loan documents and business records, and the accuracy of those documents and records. These declarations, together with client communications, are allowing attorneys to file the required affidavits and comply with the new rule.

## A SOLUTION—CONSENSUAL REMEDIES

Many of today's foreclosure litigation issues and practical problems could be remedied through the negotiation and implementation of a forbearance agreement containing meaningful remedies, such as a "consent judgment of foreclosure." It is possible this can be accomplished in the context of court-ordered mediation or settlement conferences, which are becoming more prevalent in foreclosure actions.

Both the borrower and the lender should think of this strategy as a "loan modification with remedies." It should be noted that under certain federal programs, such as the Home Affordable Modification Program (HAMP), a loan servicer cannot require that a borrower waive legal rights as a condition to a loan modification. However, HAMP loan modifications are confined to specific borrowers and mortgage loans that meet HAMP's eligibility requirements. This is the application of a classic, and effective, commercial loan workout strategy in the residential foreclosure context. We are mindful that where a borrower consents to remedies, the borrower should do so knowingly and freely, and on the advice of counsel.

From the borrower's perspective, there are several benefits. The borrower can obtain more favorable repayment terms tied to today's real estate market values (such as a reduced principal balance, a lower interest rate, suspension of amortization payments or a period of substantial forbearance), time to cure existing defaults, time to attempt to sell the mortgaged premises and plan an orderly departure (minimizing the disruption to family). The borrower also may be able to negotiate a release from personal liability for any deficiency remaining after a sale in foreclosure of the mortgaged premises as part of his consent to the foreclosure remedy.

From the lender's perspective, the lender achieves finality and predictability. The lender can cure documentation defects (such as irregularities or incomplete documentation in the chain of title), and obtain borrower's acknowledgement of the debt (including the outstanding principal balance, interest arrears and the interest to be charged going forward) and an admission that there are no defenses, offsets, counterclaims or claims against the lender. These are material benefits, especially in this era of heightened judicial scrutiny, that could easily justify economic concessions to a borrower—and perhaps save the borrower's home.

The "forbearance agreement with remedies" presents a rare opportunity for both defaulting borrowers and their lenders to "right size real estate" and come together on a feasible and practical workout plan—a win-win situation from a legal and an economic perspective. With a modicum of care, lenders should be able to secure their contractual and legal remedies and at the same time justify making lasting, and fair, concessions to their borrowers. <

**4. Other Changes to Table A:** Item 6 of Table A continues to cover zoning matters. Item 6 has been revised to add the zoning classification for the property as an optional item. However, Item 6 has been further amended to provide that the zoning classification and other zoning information are to be provided to the surveyor by the title insurer. Since title insurers do not generally provide this type of information, it will be interesting to see how the title insurers respond to this change. Another change to Table A has been the addition of the following new Items: (a) Item 2—street address of property, (b) Item 19—location of wetland areas, (c) Item 20—location of improvements within offsite easements, and (d) Item 21—furnishing of certificate of surveyor's professional liability insurance.

**5. Greater Description of Access, Easements and Servitudes:** In addition to making access to public ways a mandatory survey item, the 2011 Standards require more information to be depicted regarding access, easements and servitudes. For instance, the survey must show the width of all easements and provide information as to whether their locations are plottable or observed, whether they affect the surveyed property, and whether they are part of a blanket easement. The survey must also show the location of any other forms of access used by persons other than the occupants of the property.

**6. Inclusion of Title Commitment Information:** The 2011 Standards require the surveyor to note on the survey the title commitment or policy number, its effective date and the name of the title insurer. For owners and lenders who previously required this information on their surveys, this will not be a change. However, this requirement will help to make the use of the short-form surveyor certification more palatable to owners and lenders as this requirement was typically found in lenders' long-form certifications.

## CONCLUSION

The implementation of the 2011 Standards will not bring about any major changes to owners and lenders, other than to limit the use of customized long-form surveyor certifications. However, if owners and lenders undertake a review of their standard long-form certifications, many will find that the items contained in their certifications are already covered by the requirements contained in the 2011 Standards. Where a particular long-form certification in fact provides additional critical protections (such as flood zone information and additional zoning information), the owner or lender will need to determine how to continue to receive those protections or reasonable alternatives. One option is to obtain those protections from other vendors, like flood zone and zoning consultants, title insurers or engineering firms. Another option is to remove the item, such as flood zone or zoning information, from the certification and require it be shown elsewhere on the survey. A third option is to require the property survey to be prepared under state or local surveying standards if they do not prohibit the use of a long-form certification. However, this third option may not be a practical option for owners and lenders who own or finance real estate on a national basis. In the end, each owner and lender will need to compare their own surveying requirements against the 2011 Standards and determine whether any such alternatives are necessary or practical. We believe that most owners and lenders will end up accepting the 2011 Standards, even if grudgingly, and will rely even more on the survey coverages afforded by the title insurance policies (when the standard survey exception is deleted). <

argue that the legality of private transfer fees is supported by the broad approach of the Third Restatement.

Although from a developer's, and perhaps a buyer's, perspective there are advantages to enforcing private transfer fees, there are also many disadvantages to this type of restrictive covenant. Even though a prospective purchaser of property may negotiate a lower purchase price, when that same owner sells the property, he or she will be required to pay the transfer fee to a third party, thereby depleting a portion of the owner's equity that the owner had established over time. ALTA goes as far as to state that private transfer fees "steal equity from consumers." There is a certain amount of inherent unpredictability involved in private transfer fees. Many buyers will not find out about the existence of a private transfer fee prior to negotiating a purchase and sale agreement. Even if the buyer knows about the private transfer fee and uses it to try to negotiate a lower purchase price, the buyer can not predict the future value of the property (on which the transfer fee will be based) or the length of time the buyer will own the property (to determine how to effectively discount the offer price) at the time of the sale.

There are also significant transaction costs associated with private transfer fees. Most homebuyers are unfamiliar with the intricacies of private transfer fees and will likely need to incur legal fees and other expenses associated with interpreting and dealing with the potential complexities of these fees or locating the beneficiary of the fee in the event that the original developer sold or transferred its rights. Furthermore, lenders will require that any private transfer fee be subordinated to financing provided on the property, resulting in costs and delays associated with negotiating subordination documents. Finally, private transfer fees can have a negative effect on property values. If a private transfer fee is enforceable against successors in interest, the affected property will have a reduced value.

According to ALTA and NAR, the arguments against the enforcement of private transfer fees far outnumber and

outweigh the arguments in favor of them. In response to the increase in the imposition of such fees, representatives of ALTA and NAR have proposed a model statute (available [here](#)) that prohibits transfer fee covenants (the Model Statute). The Model Statute carves out one-time transfer fees, homeowner's association fees and non-profit organization fees as permissible. The Model Statute operates prospectively and does not expressly invalidate existing private transfer fees. However, it also states that it does not, by its terms, validate existing private transfer fees.

Further evidencing the opposition to private transfer fees, on Feb. 1, 2011, the Federal Housing Finance Agency (FHFA) issued a notice of intention to begin formal rulemaking on private transfer fees. In a related press release, the FHFA stated that the rule would "limit Fannie Mae, Freddie Mac and the Federal Loan Home Banks from dealing in mortgages on properties encumbered by certain types of private transfer fee covenants." Specifically, the press release notes that "fees that do not directly benefit the property [will] be barred."

A number of state legislatures have responded to these arguments by enacting legislation prohibiting or limiting the imposition of private transfer fees. Since the introduction of the Model Statute in 2009, 14 states have adopted comparable statutes. Notably, California adopted a statute that expressly permits private transfer fees. The California statute imposes an obligation on the developer to disclose certain information with respect to the fee, including the amount, examples of actual cost, the expiration date of the restriction, the purpose of the transfer fee, and the name of the entity to be paid.

While the adoption of the Third Restatement approach opened the door for developers seeking to enforce private transfer fees, public policy and opinion among influential groups in the field have created stiff opposition, and a number of state legislatures have responded with legislation greatly restricting their impact. It remains to be seen how they will fare in the future. <

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