



MICHIGAN ASSOCIATION OF
REALTORS®

2009 Legal Update

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SELLER FINANCING

In past years, low interest rates and ever-increasing home values all but eliminated the use of land contracts and purchase money mortgages in Michigan. However, now that many buyers cannot qualify for conventional financing and many homes will not appraise for the purchase price amount, the focus has again turned to seller financing. With seller financing, REALTORS® must recognize the fact that the seller and buyer are entering into a long-term relationship.

The use of seller financing adds a number of additional factors which a REALTOR® must consider when assisting a seller or a buyer. In the case of a seller, there are a number of new issues upon which a client may seek advice. First, what does the seller “need” as a financial return from the property on a long-term basis and what terms will most likely generate that financial return? Second, what are the seller’s standards going to be as to the creditworthiness of a prospective buyer? (If a buyer cannot qualify for a conventional mortgage, what assurance will the seller require that the buyer will perform on the land contract?) Third, the seller will be taking on the role of a lender and will want to understand the methods of enforcement of the terms of the land contract or purchase money mortgage and the costs associated with that enforcement. Fourth, the seller will wish to know whether the sale on a land contract or conveyance subject to a purchase money mortgage will cause any legal or practical problems with the seller’s own lender, whose mortgage will remain on the property. Finally, the seller must consider the pros and cons of a land contract versus a purchase money mortgage.

In working with buyers, a REALTOR® must face many of the same issues. First, the buyers will need to determine what they can afford to pay as a down payment and thereafter in monthly installments. In the past, a conventional lender determined how much buyers could pay based on a hugely optimistic assumption (*e.g.* never ending increases in value of property). Second, the buyers will probably have to deal with a seller who does not want a long-term financial relationship. Accordingly, the buyers will need to consider whether they will be in a position to perform, if in fact they enter into a land contract with a three (3) year balloon. If the buyers cannot qualify for a conventional mortgage at the time of closing, what is going to change to enable them to qualify for a conventional loan three (3) years later? Third, the buyers need to generally understand the different legal remedies that are available if the seller declares the buyers to be in default. Finally, if the underlying mortgage given by the seller is going to remain on the property, the buyers will certainly wish to understand what, if any, legal issues can arise between the sellers and the sellers’ lender. In the event of an acceleration of the indebtedness owed by the sellers to their lender, the buyers will be required to immediately obtain conventional financing to protect the investment they have in the property.

MICHIGAN LAND CONTRACTS

In order to work with land contracts in Michigan, it is essential that REALTORS® understand the basic principles that distinguish Michigan land contracts from executory contracts (*e.g.*, purchase agreements) and land contracts used in different states. In many

respects, Michigan land contracts are more akin to a mortgage than a purchase contract.

First and foremost, it is well settled in this State that the vendee in a land contract (the buyer) is vested with equitable title in the land and that legal title remains in the vendor as security for the payment of the purchase price. Upon payment of the purchase price, the vendee is entitled to conveyance of the legal title. *Barker v Klingler*, 302 Mich 282, 288 (1942).

While legal title is held by the seller as security for payments on land contract, “equitable title passes to the buyer/vendee upon proper execution of the contract.” *Zurcher v Herveat*, 238 Mich App 267, 291 (1999).

In determining whether land contract buyers “have property” within the meaning of a constitutional provision governing certain voting rights, the Michigan Supreme Court has held:

Within the broad spectrum of rights included in the term ‘property’ is the interest of a land contract vendee, according to common usage. Such an interest usually carries with it valuable rights ordinarily understood to be property rights, such as the right of possession, control and disposition. Hence, to ‘have property’ within constitutional meaning, may be said to embrace having a vendee’s interest in a land contract.

Goldsmith v Albion Public Schools, 373 Mich 397, 402 (1964).

REALTORS® should understand that there is very little difference between holding equitable title to property and holding legal title to property. This is demonstrated by the treatment of a number of issues with respect to land contracts.

First, equitable title obtained by a buyer through a land contract can be sold by the buyer and purchased by a third party. Thus, in the absence of a due-on-sale clause, a clause prohibiting prepayment or a clause requiring consent by the vendor to any sale, the buyer may sell the property on a second land contract or simply sell the property and pay off the first land contract.

Second, equitable title obtained by a buyer through a land contract can be used as a security for a mortgage. This right is now granted to a buyer by statute. MCL 565.357.

Third, the land contract or memorandum of land contract can be recorded with the register of deeds. The recording of a land contract or memorandum of land contract has the same force and effect as the recording of deeds and mortgages. MCL 656.354.

Fourth, a buyer on a land contract has an insurable interest in the property. Land contract sellers assume “the same position and status as a mortgagee for purposes of applying a mortgage clause to govern the rights of the vendor under an insurance policy issued to the land contract vendee.” *Singer v American States Ins*, 245 Mich App 370, 378 (2001).

Finally, the procedure for foreclosing a defaulted land contract is nearly identical to that for foreclosing a mortgage by judicial action. MCL 600.3101 *et seq*.

In summary, land contracts typically grant purchasers immediate possession and control of the property and the purchasers immediately obtain equitable title. Equitable title

to the property is little different from legal title: the property can be bought, sold, insured, recorded, and encumbered and can be the subject of tax liens and foreclosure.

BASIC LAND CONTRACT PROVISIONS

In dealing with land contracts, the first document in which REALTORS® will deal with the subject is the purchase agreement. There is no standard land contract form in Michigan. If a purchase agreement simply provides that a buyer will buy a property on land contract, and nothing more, the purchase agreement could very well be deemed to be too open-ended to be enforceable. A land contract must contain various terms that are not typically included in a purchase agreement. Thus, when drafting a purchase agreement for a land contract sale, a REALTOR® should do more than simply provide for a “land contract purchase.”

As one alternative, the purchase agreement can reference a specific form of land contract. If a local association of REALTORS® has a form of land contract which the REALTOR® finds appropriate, a specific reference could be made in the purchase agreement to the “local association’s current form of land contract.” Alternatively, a REALTOR® may have some other form of land contract with which he is well-acquainted and comfortable with its terms. Assuming it is appropriate for the client or customer, the form of land contract could be incorporated into the purchase agreement as an exhibit, *i.e.*, “purchaser shall purchase the property on the attached land contract form.”

There are a number of terms in a land contract that a REALTOR® should understand. A sample land contract is attached to this article as Exhibit A. The sample is provided for purposes of discussion and should not be used by a REALTOR® in a transaction unless its terms specifically fit the needs and requirements of the parties to that transaction.

First, all payment terms must be in the land contract. This includes the down payment, remaining balance, amount of monthly installments, the interest rate, the number of years of the land contract and any specific date for a balloon payment.

Second, a provision must be included that gives the buyer possession of the property during the term of the land contract. If the land contract is silent as to possession, then possession remains with the seller.

Third, the land contract should contain a provision covering property taxes. It must be determined who will be responsible for paying property taxes during the term of the land contract. Some contracts have the buyer pay the taxes directly; others have the seller collect the estimated tax amount from the buyer with each land contract payment. If the seller is going to be responsible for paying property taxes, then there is the question as to how the tax payment amounts collected will be handled. Some contracts simply have the seller hold the money in escrow until the taxes are paid. In other contracts, the seller applies these monthly payments against the principal balance as they are received. At the time the seller pays the property taxes, the principal balance of the land contract is increased by the amount of the taxes paid. Further, REALTORS® should consider whether the party paying the taxes should be required to provide evidence to the other party that the taxes have been paid.

Fourth, the land contract must contain a provision requiring the seller to deliver a warranty deed to the buyer upon the buyer’s performance to the terms of the land contract.

Generally, the provision will specify that the seller may only except from the warranty restrictions, rights and easements of record as of the date of the land contract. In other words, the seller is generally not permitted to place additional easements or other restrictions against the property during the term of the land contract. Obviously, the seller may also except from the warranty any liens caused by the acts or omissions of the buyer during the term of the land contract.

Fifth, the land contract should specifically provide that transfer taxes should be paid by the seller when the seller delivers the deed to the buyer. Alternatively, the provision could provide that the buyer will deduct the amount of the transfer taxes from the final installment(s) on the land contract and pay the transfer taxes when the buyer records the deed.

Sixth, the land contract should contain provisions with respect to liability and casualty insurance in the event of any damage during the term of the contract. The seller will certainly want insurance in place on the property during the term of the land contract to assure payment if the property is damaged, *e.g.*, the house burns down. The land contract should provide who will pay for the insurance (the seller or buyer) and what, if any, evidence the party paying for the insurance shall provide to the other party. The party not paying for the insurance may request to be an additional insured on the policy and/or to receive notice in the event of cancellation of the policy. The notice of cancellation would, for example, protect a seller if a buyer failed to pay for insurance on the property, since it would give the seller an opportunity to purchase his own insurance.

Seventh, a provision should be included in the land contract which specifies whether the buyer can or cannot transfer its interest in the land contract without the prior consent of the seller. As importantly, this provision should specify whether the buyer will or will not remain liable under the land contract after the transfer.

The provisions for payment on a land contract should specify whether the buyer can prepay installments owed on the land contract and/or prepay the land contract in full. If a buyer wishes to be able to prepay installments, the words “or more” should follow the statement of the amount of the monthly payment, *e.g.*, “the remaining balance of ___ dollars to be paid in monthly installments of ___ dollars **or more.**”

Eighth, in representing a seller, a REALTOR® may want to obtain a provision which prevents a buyer from making any substantial changes to the property without the prior consent of the seller. The reason sellers would want this provision is fairly straightforward. If the sellers have sold their residence on land contract for \$100,000, and the buyer seeks to rebuild the entire interior of the residence, the sellers would have great interest in making certain that the value of the property did not end up diminished by the buyer’s actions. On the other hand, a buyer may resist such a provision if it is believed that the seller may not be reasonable in granting consent to any substantial changes to the property, particularly if it is a long-term contract. As a corollary, a seller will also wish a provision requiring the buyer to maintain the property in good condition, reasonable wear and tear excepted, and to agree not to commit “waste” on the property.

Ninth, a provision should be included in the land contract regarding the seller’s right to place mortgages on the property. It must be remembered that the seller still has legal

title to the property. If the seller is going to be permitted to place a mortgage on the property, the contract typically provides that the mortgage amount shall not exceed the balance owed under the land contract. In addition, the contract typically provides that the amount of monthly payments of interest and principal on the mortgage cannot exceed the amount of monthly payments required under the land contract. These provisions are essential in the event that the buyer wishes to assume the seller's mortgage or is required to step into the shoes of the seller with respect to that mortgage.

Tenth, the buyer will obviously want to make certain that the seller can provide marketable title to the property after the buyer's performance of the terms of the land contract. Thus, the purchase agreement would require the seller to provide a title commitment evidencing marketable title and, thereafter, a title insurance policy. The land contract would then contain a provision indicating that the buyer had received a title insurance policy covering the property and that the buyer accepts the condition of the title as disclosed in the policy.

Eleventh, the land contract should contain a provision granting the seller the right to provide a written notice of forfeiture in the event the buyer defaults under the terms of the land contract and granting the seller the right to forfeit the land contract. This provision should also permit the seller to exercise any other legal remedies available. Remedies in the event of default will be discussed more fully below.

REALTORS® representing sellers may wish to make certain that a provision is included in the land contract acknowledging that the buyer has purchased the property in its "as is" condition. This clause could be very helpful for a seller in the event a dispute arises during the term of the land contract with respect to the condition of the property. Unlike a situation where a buyer purchases a property and receives a deed at closing, the buyer does not have to go to court to try to obtain financial leverage on the seller. Instead, the buyer may simply withhold or claim to deduct from installment payments on the land contract, the amount of any claimed damages.

Finally, a provision should be included in the land contract indicating that a memorandum of land contract will or will not be recorded with the register of deeds upon the execution of the land contract.

MEMORANDUM OF LAND CONTRACT

As indicated above, land contracts and memorandums of land contracts can be recorded with the register of deeds. Typically, it is not in the interest of either the seller or the buyer to have the actual land contract recorded with the register of deeds, thus making the terms of the land contract available to the entire world. An alternative is a memorandum of land contract. A sample form of memorandum of land contract is attached to this article as Exhibit B. As can be seen, the memorandum of land contract does not disclose any of the financial terms of the land contract. However, there can be competing interests between the seller and a buyer as to whether even a memorandum of land contract should be recorded.

A simple hypothetical will demonstrate why at times sellers will fiercely resist the recording of memorandum of land contract. Assume Seller Brown sells her property on land contract to Buyer Green. The land contract calls for a term of five (5) years, at which time

the remaining balance shall be paid in the balloon payment. In the middle of the third year, Seller Brown does not receive a payment from Buyer Green. Seller Brown has been relying on those payments to pay the underlying mortgage on the property sold to Buyer Green. Seller Brown visits the property and finds that it is vacant. Buyer Green has left a note in the kitchen indicating that he is moving out, leaving the country and will not be making any further payments on the land contract. Seller Brown immediately lists the property for sale. A new buyer is found for the property who will purchase it using conventional financing. Unfortunately, the sale cannot proceed forward promptly, as the title company lists, as a requirement in a title commitment, that the memorandum of land contract memorializing the sale of a property of Buyer Green, either be discharged or an action to forfeit Buyer Green's interest or quiet title action be prosecuted to eliminate the interest reflected in the memorandum of land contract.

A simple hypothetical will also demonstrate why buyers should insist that a memorandum of land contract be recorded evidencing their equitable title in the property. Assume Buyer Green purchases property from Seller Brown on the land contract, which calls for three (3) years of installment payments and then a balloon payment. A memorandum of land contract is recorded with the register of deeds to evidence Buyer Green's interest in the property. Buyer Green faithfully makes installment payments for three (3) years and arranges for conventional financing to pay the balloon. Immediately prior to closing, it is discovered that during the second year of the land contract, a judgment was entered against Seller Brown and the judgment now appears to be a lien on the legal title of Seller Brown. Since a memorandum of land contract was recorded, the judgment lien is subordinate to Buyer Green's interest in the real estate. He may purchase the property free clear of the judgment lien. In the absence of the memorandum of land contract, Buyer Green's interest in the property would be subordinate to the judgment lien. This would be a serious problem if the balance owed on the land contract was less than the judgment lien amount. (If the judgment lien was smaller than the balance owed, Buyer Green could commence a legal action against the judgment lienor and the seller to obtain direction from a court as to who should receive what part of the balloon payment.)

It should be noted that tax liens generated by a seller asserted against the property after the date of recording of the memorandum of land contract would also be subordinate to Buyer Green's interest in the property. Again, Buyer Green would typically handle this situation by commencing litigation to obtain direction from the court as to who should be paid what part of the balloon payment owed to Seller Brown.

REMEDIES FOR DEFAULT BY BUYER

If buyers fall behind on the installment payments on their land contract, fail to timely pay property taxes (as required to do under the contract) or otherwise default on the land contract, there are essentially three (3) remedies available to the seller. Each of these remedies differs both in terms of time and cost to pursue and possible outcomes.

1. Foreclosure through the Circuit Court.

If the seller definitively wishes to end the relationship with the buyer, *i.e.*, cause the buyer to either pay off the land contract in full or terminate the land contract, then the

seller will have to pursue foreclosure proceedings through the circuit court. Moreover, this remedy is the only remedy that will permit a seller to obtain a deficiency in the event that the property value is less than the balance owed on the land contract. Unfortunately, unlike with a mortgage, a land contract seller cannot pursue the foreclosure of the land contract by advertisement (*i.e.*, publish a notice of foreclosure for four weeks in a countywide newspaper and then hold a foreclosure sale), as such a process is not authorized under Michigan law.

The pursuit of foreclosure on a land contract in the circuit court is extremely costly and time consuming. It should be pursued only if a seller has determined that the buyer is collectible for any deficiency judgment and/or has the ability to pay off the entire balance of the land contract. Even if the buyer does not choose to effectively defend the foreclosure action in the circuit court, it will take a minimum of ten months to foreclose the land contract and obtain possession of the property. Michigan law provides that a circuit judge shall not order property which is subject to the land contract to be sold for at least three (3) months after the filing of the complaint for foreclosure of a land contract. MCL 600.3115. Thereafter, assuming the property is a typical single family residence, there is a six (6) month redemption period during which the buyer may continue to occupy the property without payment of any kind to the seller.

If the buyer chooses to contest the foreclosure of the land contract, it is typically through the assertion of a counterclaim in the circuit court alleging that the seller used fraud to induce the buyer to enter into the land contract and/or the seller is otherwise not entitled to foreclose the property. If this occurs, it is not possible to predict how long the litigation would last. The length of the litigation would be dependent in large part on the docket of the specific court, the attitudes of the specific judge, and the resources of the buyer available to prolong the litigation.

For these reasons, it is extremely seldom that a seller seeks to foreclose a land contract in the circuit court. Again, typically this course of action only occurs when the buyer is either collectible for any deficiency and/or it is anticipated that the buyer will have the desire and the wherewithal to obtain a mortgage and pay off the land contract.

2. Forfeiture through the District Court.

The procedure generally followed by sellers is the forfeiture process through a Michigan district court. The forfeiture process allows the purchaser to stop the process by simply paying past due installments and any other past due obligations. If the buyer does not cure the default, the buyer's interest in the property is forfeited and the seller regains possession. The seller is not entitled to any money judgment. This procedure is only available to sellers if their land contract specifically provides for forfeiture, *i.e.*, gives the sellers the right to declare forfeiture in the event of the non-payment of monies required to be paid under the contract or any other material breach of the contract. A seller begins the forfeiture process in the district court by sending a written notice of forfeiture. The State of Michigan provides a specific form for this notice. The notice of forfeiture may be either personally delivered to the buyer or mailed to the buyer by first class mail addressed to the last known address of the buyer.

A complaint is then filed with the district court, again on a form provided by the State of Michigan. Thereafter, under Michigan law, the proceeding is to be held within fifteen

(15) days to forfeit the land contract, provided that the summons is served on the buyer not less than ten (10) days before the date set for trial. As a practical matter, most district courts are simply too busy to schedule a trial date within fifteen (15) days from the date of issuance of a summons.

Buyers can demand a trial by jury if there is anything to argue about and if they have the resources to do so. Ultimately, the court will determine any past due amounts owed by the buyers under the terms of the land contract. In most instances, the judgment for possession will be enforced by a writ of restitution, which shall not be issued until ninety (90) days after the entry of the judgment, assuming more than 50% of the purchase price in the land contract remains to be paid. (If less than 50% of the purchase price of the land contract remains to be paid, then the writ of restitution will issue six (6) months after the date of entry of the judgment for possession.) If the buyer pays the amount set forth in the judgment of possession during the 90-day period, plus any amounts accruing on the land contract during the 90-day period, then the land contract continues in full force and effect.

If the buyer fails to pay the amount set forth in the judgment of possession during the typical ninety (90) day period, upon issuance of the writ of restitution, the land contract is forfeited and the seller may regain possession of the premises. However, it is important for a seller to understand that the buyer has no further financial obligation to the seller. In other words, if at the time the judgment of possession was entered, the buyer owed \$4,000 in the form of four (4) unpaid monthly installments of \$1,000 and the buyer remained in the possession of the property during the ninety (90) day period, the seller is not entitled to \$7,000. In sum, under Michigan law, a forfeiture action is designed to provide greater speed in pursuing a defaulting buyer, but less potential financial gain for the seller.

3. Breach of Contract in the Circuit Court.

Upon the default by a buyer in a land contract, a seller may decide not to pursue either foreclosure or forfeiture. Instead, the seller may decide to simply sue the buyer for breach of contract. In this instance, the seller will not pursue any claim to the property subject to the land contract, but instead will ask for the money owed. A simple hypothetical will demonstrate how this could occur.

Assume Seller Brown sells 123 Elm Street to Buyer Green on land contract for \$125,000 with \$20,000 down and the remainder in monthly payments amortized over thirty (30) years with a five (5) year balloon. Upon closing, Seller Brown moves to Florida. During the third year of the land contract, the payments from Buyer Green cease. Seller Brown, being unable to get in touch with Buyer Green, travels back to Michigan. When she arrives in Michigan, she discovers that her house at 123 Elm Street is now a vacant lot. She was unaware that the property had been tagged by the City and eventually torn down by the City. The land subject to the land contract is now worth only a few thousand dollars.

If Seller Brown determines that Buyer Green is collectible at least in part, she may initiate an action in the circuit court for money damages.

DUE-ON-SALE CLAUSES

A due-on-sale clause is a clause in a mortgage which permits the lender to declare a default, accelerate the debt and foreclose the mortgage in the event the seller

conveys or transfers an interest in the property subject to the mortgage without the prior written consent of the lender. Until otherwise advised by a lawyer for the seller, REALTORS® should always assume that a mortgage on the seller's property has a due-on-sale clause. Further, it should be understood that a sale on land contract, without the consent of the lender, would permit a lender to exercise its rights under the due-on-sale clause. Thus, sellers seeking to sell their property on land contract subject to an existing mortgage should seek to obtain the consent of their lender.

In the early 80s, there was a significant dispute carried out in the courts, in Congress and in the executive branch as to the enforceability of due-on-sale clauses. Ultimately, the uncertainty was resolved and due-on-sale clauses are now clearly enforceable. This was accomplished through legislation passed by the Michigan Legislature. MCL 445.1627 provides:

Each contract for the sale or transfer of residential property which is subject to a mortgage shall provide in boldface type substantially as follows:

'Seller understands that consummation of the sale or transfer of the property described in this agreement shall not relieve the seller of any liability that seller may have under the mortgage(s) to which the property is subject, unless otherwise agreed to by the lender or required by law or regulation.'

Most forms of purchase agreements no longer contain the language specified in MCL 445.1627, simply because due-on-sale clause enforcement has been a non-issue for over twenty (20) years. It may be time to put the clause back in purchase agreements as required by law.

MCL 445.1628 provides:

(1) A lender who knowingly enforces or attempts to enforce a due-on-sale clause in violation of this act shall be liable for a civil fine not to exceed \$5,000.00 for each offense. The attorney general or a prosecuting attorney may bring an action to recover a civil fine under this section.

(2) Any person licensed to do business in this state who, while carrying on that business, knowingly advises a person selling or transferring property securing a residential window period loan not to notify a lender as required by section 3 or who knowingly otherwise aids or assists a person in evading the enforcement of a due-on-sale clause enforceable under this act shall be liable for a civil fine not to exceed \$5,000.00 for each offense and shall be subject to revocation of his or her license.

(3) The attorney general, a prosecuting attorney, or any other person may bring an action for 1 or both of the following:

(a) A declaratory judgment that a method, act, or practice violates this act.

(b) An injunction to enjoin a lender, real estate broker, or real estate salesperson which is engaging or is about to engage in a method, act, or practice which violates or would violate this act.

(4) In addition to any other remedy provided by this act, a person who suffers loss as a result of a violation of this act may bring an action to recover actual damages or \$250.00, whichever is greater, together with reasonable attorneys' fees.

Subsection (2) specifies that any licensee “who knowingly otherwise aids or assists a person in evading the enforcement of a due-on-sale clause enforceable under this act shall be liable for a civil fine not to exceed \$5,000.00 for each offense and shall be subject to revocation of his or her license.” This provision does not require REALTORS[®] to act as the due-on-sale clause police. There is no affirmative obligation on the part of a REALTOR[®] to contact the sellers' lender to make sure it has been provided notice or to otherwise coerce the sellers into contacting their lender to obtain consent to a land contract sale. A REALTOR[®] simply must not aid or assist a person in evading enforcement of a due-on-sale clause.

It is recommended that any sellers contemplating a sale on land contract or a conveyance subject to a purchase money mortgage be advised in writing that they should notify their lender to seek consent to the sale. This writing should be in a form such that the REALTOR[®] can demonstrate, if ever necessary, that he or she specifically advised the sellers that their mortgage may contain a due-on-sale clause and that they should contact their lender to obtain consent to the sale.

PURCHASE MONEY MORTGAGE MORTGAGES

By statute, a purchase money mortgage means a mortgage secured by a first or junior lien retained by a seller of real property to secure all or part of the purchase price of the property. MCL 438.31c(7)(a).

A form of purchase money mortgage is attached to this article as Exhibit C. Optionally, any seller taking a purchase money mortgage to secure payment of the purchase price by buyer should have a mortgage form reviewed by his or her lawyer. It is essential for the protection of the seller that the purchase money mortgage contain many of the key provisions discussed above with respect to land contracts. In addition, a purchase money mortgage should also contain a provision granting the seller the right to foreclose the property by advertisement.

The fundamental difference between a land contract and a purchase money mortgage is that the buyer receives legal title at closing and the amount owed to the seller is secured by the mortgage. With a purchase money mortgage, the debt owed to the seller is evidenced by a promissory note. A sample form of note is attached as Exhibit D.

With a purchase money mortgage, there is no remedy available to a seller similar

to the forfeiture proceedings for a land contract. The remedies available to the seller with a purchase money mortgage are the same as those available to any conventional lender. The seller may foreclose the property by advertisement and then sue the buyer for any deficiency, *i.e.*, where the amount is bid at the foreclosure sale is less than the amount owed. Alternatively, the seller may foreclose the mortgage in the circuit court. This is not typically done, as it requires too much time and expense.

USURY

With seller financing, there will always be an issue as to what interest rate the seller will charge on the indebtedness, whether it is evidenced by a land contract or a promissory note secured by a mortgage. Specific limitations are imposed on how much a seller may charge as interest in those situations. REALTORS® should not attempt to provide expertise on interest limitations as the civil penalty for a violation is extremely onerous, *i.e.*, a loss of payment of any interest on the remaining indebtedness. Thus, any questions on usury or the permissible interest rate should be referred to an attorney.

There are a few “safe harbors” which are available:

First, there is no question that an individual seller on land contract can charge a rate of interest not to exceed eleven percent (11%) percent per annum. MCL 438.31c(6). Further, a seller taking a purchase money mortgage may also charge a rate of interest not to exceed eleven percent (11%) per annum. MCL 438.31c(7).

Second, the parties to a land contract or mortgage may provide for an adjustable rate of interest up to eleven percent (11%). However, as a practical matter, this is not recommended. Fierce battles have been fought over the years trying to decipher and apply variable interest rate formulas generated by sellers and buyers.

Third, the parties to indebtedness of \$100,000 or more, the bona fide primary security for which is a lien against real property other than a single family residence, or to a land contract of the same amount and nature; may agree in writing for the payment of any rate of interest. Obviously, there can be some dispute over which type of real property would be covered. REALTORS® involved, for example, in a sale on land contract of a 200-acre farm, upon which there is a two-story farmhouse, would be well advised to seek an opinion of a lawyer if a rate of interest in excess of eleven percent (11%) is going to be charged.

There are other rules regarding usury which apply to interests on a land contract. If a REALTOR® finds himself in a situation where interest is going to be calculated and adjusted based on some unconventional method, he should seek guidance from someone knowledgeable in this area. For example, if the land contract provided for a rate of interest added in advance or called for the calculation of interest on the land contract to be computed on some basis other than unpaid balance, it is most likely that the land contract and the calculation of interest will violate the law. MCL 438.31c(9).

LEASES WITH OPTIONS TO PURCHASE

Lease with options to purchase are another method for seller financing. MAR previously provided an article on leases with options to purchase in 2008. The contents of that article are reprinted here for ease of reference and to make sure that all types of seller

financing tools are included within this article.

A. *Crafting a Proper Option to Purchase*

An option to purchase gives the holder the right to elect to purchase a property at a particular price. In other words, an option is an irrevocable offer to sell a property for a particular period of time. If the option is exercised, it must be executed prior to its stated expiration date. Unlike time deadlines in other contracts, traditionally Michigan courts have strictly enforced time deadlines in option contracts. This is true for the other terms of an option contract as well. So, for example, if an option provides that you must exercise the option by hand delivering written notice to the seller, do not attempt to exercise your option via email.

An option should be effective upon its exercise. It should not require parties to execute a separate purchase agreement. Because of this, an option contract should spell out the essential terms of the purchase – *e.g.*, title insurance requirements, commission obligations, inspection requirements, tax proration methods, etc. Without these provisions, the option may be difficult to enforce. If, for example, I have an option to buy your home for \$200,000, but we have not agreed upon the other essential terms of purchase, then rather than attempt to draft these additional terms on our behalf, a court may simply find the agreement to be unenforceable. A sample form of option clause for a lease agreement is attached as Exhibit E.

It is typical, but not necessary, for some portion of the rental payments received during the term of the lease to be applied toward the purchase price in the event the option is exercised. Option fees are typically forfeited in the event the option is not exercised. Again, however, this is a matter subject to negotiation.

In order to encourage a tenant to make timely rental payments during the term of the lease, a seller may wish to consider including a clause that provides that the tenant's purchase rights will automatically terminate in the event of a default (or a series of defaults) under the lease.

B. *Memorandums/Recording*

To protect their rights in a home as against subsequent purchasers, persons holding an option to purchase will want to have an interest of record with the appropriate register of deeds. While the option itself may be recorded, oftentimes parties prefer to record a memorandum which simply acknowledges the existence of the option, but does not make the terms of such contract a matter of public record. A sample memorandum of option is attached as Exhibit F. A party may wish to omit notary blocks from the option agreement itself in order to prevent the other party from later recording the instrument.

C. *Due-on-Sale Issues*

Most, if not all, residential mortgages contain a due-on-sale clause which requires that a mortgage be paid off if there is a change in ownership. Federal law specifically provides that due-on-sale clauses are enforceable by federally regulated lenders. Other lenders are governed by the somewhat more complicated Michigan statute. As a general rule, REALTORS® should assume that a mortgage contains a due-on-sale clause and that it is enforceable.

A typical due-on-sale clause provides something like this:
If all or any part of the property is transferred without the lender's prior written consent, the lender may require all sums secured thereby immediately due and payable.

Whether a due-on-sale clause is triggered by a lease/option may depend on the specific language of the due-on-sale clause and/or the terms of the lease/option itself. Many mortgages expressly provide that specific types of leases and/or leases/options will trigger the due-on-sale clause. Others provide generally that the clause applies in the event of a transfer of *any interest* in the property.

Commentators often point out that there are no federal or state statutes that make it a crime to violate a due-on-sale clause. It is simply a contractual obligation pursuant to which if the lender discovers the transfer, it may choose to call the loan. While this is certainly true, REALTORS® should never advise a client as to whether a particular due-on-sale clause covers lease options or whether it is likely that the lender will discover the transfer and call the loan. While it is not against the law to violate a due-on-sale clause, it is against the law for a person who is licensed to do business in this state to knowingly assist a person in evading the enforcement of a due-on-sale clause. MCL 445.1628(2). A real estate licensee can be fined up to \$5,000 for each offense and be subject to revocation of his license for a violation of this law. Sellers should be advised that it is almost certain that their mortgage contains such a clause and that they should discuss this matter with an attorney before proceeding forward with a lease/option agreement.

D. Principal Residence Exemption and Other Property Tax Issues

A home that is leased does not qualify for the principal residence exemption (previously known as a "homestead exemption"). As a result, a homeowner who leases his home may experience a significant property tax increase.

Moreover, a lease option will be a transfer subject to the "pop up" tax if the lease is for more than 35 years (including all renewal options) or if the option price is not more than 80% of the property's projected value at the end of the lease.

If the tenant defaults and the lease is terminated, the homeowner will not be able to resurrect his homestead exemption. Once the home is leased, the homestead exemption is forever lost unless a homeowner moves back into his home and reestablishes it as his principal residence. Returning to the home will not, however, help a homeowner whose taxable value has been adjusted as a result of a lease/option. A homeowner who moves back into his house after suffering through a bad tenant may, with time, be able to reestablish his homestead exemption, but will not be able to reestablish the taxable value as the value that was in place prior to the lease/option.

E. Local Rental Ordinance Issues/Restrictions

Persons who wish to rent their homes should check with their local government to determine whether there are any required permits, licenses, inspections or fees. There may also be applicable subdivision or condominium restrictions of record that prohibit or restrict rentals. And there may be unique issues depending upon the location of the property. For example, the City of East Lansing has an ordinance pursuant to which

rentals are prohibited in certain areas within the City. Over the years, the City of East Lansing has also settled many code violation matters by imposing a “consensual” deed restriction which prohibits any future rentals of that particular home. The only way to know about leasing restrictions is to contact the municipality and also to obtain a title search.

F. Insurance Issues

Many insurance policies require continued owner occupancy. While obviously there are policies available for leased homes, the premium is typically higher. Homeowners should discuss this issue with their insurance agent before they lease the home. A seller who does not address this issue who suffers a fire or other casualty may end up with a denied claim. While the cost of insurance may be passed onto a tenant, the homeowner will want to make sure that he is protected by obtaining the coverage himself and collecting reimbursement from this tenant.

G. Financial Risks to Owners and Tenants

A tenant with an option to purchase will want to make certain that the homeowner does not owe more on his house than the option price. Similarly, if the homeowner/landowner is responsible for paying taxes and insurance, the tenant will want to make certain that these items are current. These concerns are particularly important where the tenant will have a significant investment in the property by the time the option is exercised.

The homeowner, on the other hand, will want to take steps to protect his investment should the tenant be unwilling or unable to exercise the option to purchase. A homeowner typically will want control over the extent and nature of any renovations made to the home before the home is actually sold. Likewise, the homeowner will want control over sublets and assignments of the lease/option rights.

CONCLUSION

REALTORS[®] who were in the business in the early 1980s were well acquainted with the seller financing tools described in this article. Fortunately or unfortunately, there has been little reason for that knowledge to be passed down over the past twenty years. It would now appear incumbent upon all REALTORS[®] to become acquainted with these tools as it would appear that they will receive widespread use at least until lenders begin lending money again based upon reasonable terms and reasonable appraisals.

EXHIBIT A

LAND CONTRACT

THIS LAND CONTRACT is made as of the _____ day of _____, 20____, between _____ (“Seller”), whose address is _____, and _____ (“Purchaser”), whose address is _____.

In consideration of the mutual covenants herein contained, it is hereby agreed as follows:

1. **Property.** Seller hereby agrees to sell and convey to Purchaser a certain parcel of land (the “Premises”), located in the Township/City of _____, County of _____, State of Michigan, commonly described as _____ and legally described on attached Exhibit A.

2. **Price and Terms of Payment.** Purchaser agrees to buy the Premises and to pay Seller the sum of \$_____ (the “Purchase Price”) as follows: \$_____ on signing this Contract, the receipt of which is acknowledged, and the remaining balance of \$_____ to be paid in monthly installments of \$_____ or more, including interest which shall accrue at the rate of ____ percent (____%) per annum over _____ (____) years commencing on _____, 200__ and on the first day of each month thereafter until _____, 20__, at which time the entire balance of principal and accrued interest shall be due and payable.

Purchaser may prepay this Contract in whole or in part at any time. Partial prepayments shall be applied to payments due hereunder in the inverse order of their maturity.

3. **Late Payments.** Any payment of principal and interest not paid when due shall be assessed a one-time late charge of five percent (5%) and in addition shall bear interest at the rate of _____ percent (____%) per annum.

4. **Possession.** Possession of the Premises shall be delivered to Purchaser at Closing, subject only to: _____.

5. **Condition of Premises/Repairs/Improvements.** Purchaser has examined the Premises and is accepting such in their “as is” condition. Purchaser covenants to maintain the Premises in a good condition as they are at the date hereof, reasonable wear and tear excepted, and not to commit waste, remove or demolish any improvements thereon or otherwise diminish the value of Seller’s security, without the written consent of Seller.

6. **Condition of Title.** Purchaser has received a title insurance policy covering the Premises and agrees to accept as marketable the title disclosed thereby.

7. **Insurance.** Purchaser shall carry liability and casualty insurance on the Premises with companies and in amounts acceptable to Seller, naming Seller as additional insured and shall provide Seller with evidence thereof. Any such policy shall require ten (10) days' prior written notice of cancellation to Seller.

8. **Taxes.** Purchaser shall enter the Premises for taxation in its name and shall pay, prior to the imposition of any interest or penalty, all taxes and assessments which become a lien on the Premises after the date hereof. Any special assessment may be paid in installments if permitted by the taxing authority.

9. **Insurance and/or Tax Default.** If Purchaser defaults in making any required payments of taxes, assessments or insurance premiums within ten (10) days after Seller's written demand, Seller may pay same, including any interest or penalty, and the amount so paid shall be due at once, shall be added to the unpaid balance of this Contract, and shall be a lien on the Premises.

10. **Disposition of Insurance Proceeds.** During this Contract, any proceeds from a hazard insurance policy shall first be used to repair the damage and restore the Premises. If the insurance proceeds exceed the amount required for repairing or rebuilding, the excess shall be applied first toward the satisfaction of any existing defaults under the terms of this Contract and then as a prepayment upon the principal balance owing, without penalty, notwithstanding any other provision herein to the contrary. The prepayment shall not defer the time of payment of any remaining payments required under paragraph 2 hereof.

11. **Conveyance.** Upon full performance of Purchaser's covenants hereunder, Seller shall deliver to Purchaser a warranty deed, excepting only from the warranty, restrictions, rights and easements of record on the date hereof, taxes which Purchaser is obligated to pay and defects of title due to the acts or omissions of Purchaser. The deed shall convey the Premises to Purchaser or, at its option, to such other entity as Purchaser may designate. Transfer taxes due and owing shall be paid by Seller.

12. **Assignment.** Purchaser may not transfer its interest in this Contract or the Premises without the prior written consent of Seller. Furthermore, no transfer of the Premises by Purchaser shall release Purchaser from liability to Seller except in the case of explicit written release by Seller.

13. **Seller's Right to Mortgage.** Seller reserves the right to convey its interest in this Contract. In addition, Seller may place one or more mortgages on the Premises, provided that at no time shall the total amount secured by such mortgage(s) secure more than the

balance owing under this Contract, nor shall the total amount of the payments of interest and principal on such debt(s) exceed the payment amounts hereunder.

14. **Enforcement on Default.**

a. If Purchaser defaults in making any payment required hereunder or commits any other material default of this Contract, Seller may give Purchaser written notice of forfeiture of this Contract in the manner prescribed by law. If default is not cured within such time as is permitted by law, said Contract shall be forfeited to Seller. All payments made on said Contract shall belong to Seller as stipulated damages for breach of said Contract and Purchaser and all persons holding possession under it shall be liable to be removed from possession of the Premises in any manner provided by law.

b. Notwithstanding the provisions of the preceding paragraph 14(a), Seller may elect to pursue any other legal or equitable remedy which Seller may have available to it in consequence of Purchaser’s default hereunder. Seller also has the right to declare the entire balance of principal and interest immediately due and payable after default by Purchaser.

15. **Time is of the Essence/Notice.** It is hereby expressly agreed that time is of the very essence of this Contract. It is further agreed that all notices shall be conclusively presumed to be served upon the parties hereto when deposited in the United States mail, enclosed in an envelope with postage fully prepaid thereon, addressed to such party at the address given in the heading of this Contract or at such other address as may be specified in writing, from time to time.

16. **Compliance/Indemnification.** Purchaser will comply with all laws and regulations applicable to the Premises and will promptly notify Seller of receipt of any notice of a violation of any such law or regulation. Purchaser will indemnify and hold Seller harmless from and against any and all claims, losses and liabilities caused by Purchaser’s breach of this paragraph.

17. **Record Interest.** Neither party may record this Contract. At the request of Purchaser, Seller will execute a Memorandum of Land Contract for the purpose of providing record notice of Purchaser’s interest in the Premises.

18. **Additional Provisions.** _____

IN WITNESS WHEREOF, the said parties have executed this Land Contract as of the day and year first written above.

PURCHASER:

SELLER:

**Exhibit A
to Land Contract**

LEGAL DESCRIPTION

EXHIBIT B

MEMORANDUM OF LAND CONTRACT

THIS MEMORANDUM OF LAND CONTRACT is entered into as of this _____ day of _____ 20____, by and between _____, whose address is _____ ("Seller") and _____, whose address is _____ ("Purchaser").

WITNESSETH:

WHEREAS, Purchaser and Seller have entered into a Land Contract and desire to enter into this Memorandum of Land Contract to give record notice of the existence of the Land Contract.

NOW, THEREFORE, IN CONSIDERATION of the premises and other good and valuable consideration, the Seller acknowledges and agrees that the following described Property situated in the City/Township of _____, County of _____, State of Michigan, was sold to the Purchaser on land contract.

LEGAL DESCRIPTION

The purpose of this Memorandum of Land Contract is to give the record notice of the existence of the aforesaid Land Contract.

IN WITNESS WHEREOF, the parties have entered into this Memorandum of Land Contract as of the day and year first above written.

SELLER:

STATE OF MICHIGAN)
) ss.
COUNTY OF _____)

Acknowledged before me, in _____ County, Michigan on this _____ day of _____ 2009, by _____.

_____, Notary Public
_____, County, Michigan
My Commission Expires: _____

PURCHASER:

STATE OF MICHIGAN)
) ss.
COUNTY OF _____)

Acknowledged before me, in _____ County, Michigan on this _____ day of _____ 2009, by _____.

_____, Notary Public
_____, County, Michigan
My Commission Expires: _____

Drafted by and when recorded return to:

EXHIBIT C

PURCHASE MONEY MORTGAGE

1. Date. The date of this Mortgage is _____.

2. Parties. "Mortgagor" shall mean the buyers, _____ and _____, husband and wife, whose address is _____
_____. "Mortgagee" shall mean the sellers, _____ and _____, husband and wife, whose address is _____.

3. Mortgage and Warranty of Property. Mortgagor mortgages and warrants to Mortgagee the "Property" described on attached Exhibit A. The Property shall include land together with all of the improvements now or hereafter erected on the land.

4. Debt Secured. This Mortgage secures repayment of a purchase money note given by Mortgagor in the amount of _____ Dollars (\$ _____) (the "Note") which shall be referred to in this Mortgage as the "Debt."

5. Title to Property. Mortgagor covenants that Mortgagor is the lawful owner of the Property and has the right to mortgage, grant and convey the Property, and that Mortgagor will warrant and defend the title to the Property against all claims and demands.

6. Payment of Debt and Performance of Obligations. Mortgagor shall promptly pay the Debt when due, whether by acceleration or otherwise. Mortgagor shall promptly perform all obligations to which it has agreed.

7. Taxes, Assessments, Charges. Mortgagor shall pay when due, and before any interest, collection fees or penalties shall accrue, all real estate taxes, special assessments, water and sewer charges, or other governmental charges and impositions levied or assessed with respect to the Property.

8. Insurance. Until the Debt is fully paid, Mortgagor shall keep the buildings and other Property improvements constantly insured for Mortgagee=s benefit against fire and other hazards and risks customarily covered by the standards form of extended coverage endorsement available in Michigan, and against other hazards as the Mortgagee may require from time to time. The amount of insurance shall be sufficient to pay off the Debt in the event

of a loss requiring the insurance company to pay the policy limit. All insurance policies shall include the Mortgagee as named insureds, shall include loss payable clauses in favor of the Mortgagee, and shall be noncancellable except upon giving the Mortgagee at least thirty (30) days' prior written notice. If the Mortgagor fails to pay insurance premiums, the Mortgagee at its option may pay the premiums and the amounts paid shall become a part of the Debt. In the event of loss or damage, insurance proceeds shall be paid only to the Mortgagee. No such loss or damage shall itself reduce the Debt.

9. Waste. The Mortgagor shall keep the Property in good order and repair, and the Mortgagor expressly agrees that it will not do or permit waste on the Property not do any other act whereby the Property will become less valuable, or the lien of this Mortgage may be impaired. Failure of the Mortgagor to pay any taxes or assessments assessed against the Property or any premiums payable with respect to any insurance policy covering the Property, shall constitute waste, as provided by Act No. 236 of the Michigan Public Acts of 1961, as amended (MCL 600.2927).

10. Reimbursement of Mortgagee's Advances. If the Mortgagor fails to perform its obligations under this Mortgage, or if any action or proceeding is commenced which materially affects the Mortgagee's interest in the Property, then the Mortgagee, at its sole option, may make appearances, disburse sums, and take action as they deem necessary to protect their interest (including, but not limited to, disbursement of reasonable attorneys' fees and entry upon the Property to make repairs). Any amounts disbursed pursuant to this paragraph shall become additional Debt.

11. Condemnation. Mortgagor assigns to Mortgagee all sums at any time awarded to Mortgagor in connection with any condemnation or other taking of the Property, or any part of the Property, or for a conveyance in lieu of condemnation. These sums will be credited to the Debt and will be applied to the last maturing installments.

12. Default, Power of Sale, Remedies. Upon default in payment of the Debt, or upon default by the Mortgagor in any promise or agreement in this Mortgage, the Mortgagee shall have all remedies afforded by law and equity, including, but not limited to, the power to sell the Property at public auction pursuant to law, and out of the proceeds to retain all sums due the Mortgagee, including the costs of the sale and reasonable attorneys' fees, rendering any surplus to the Mortgagor. All rights and remedies are distinct and cumulative to any other right or remedy under this Mortgage, or afforded by law or equity, and may be exercised concurrently, independently, or successively.

WARNING: THIS MORTGAGE CONTAINS A POWER OF SALE AND UPON DEFAULT MAY BE FORECLOSED BY ADVERTISEMENT. IN FORECLOSURE BY ADVERTISEMENT AND THE SALE OF THE MORTGAGED PREMISES IN CONNECTION THEREWITH, NO HEARING IS REQUIRED AND THE ONLY NOTICE REQUIRED IS THE PUBLICATION OF NOTICE IN A LOCAL NEWSPAPER AND THE POSTING OF A COPY OF THE NOTICE ON THE MORTGAGED PREMISES.

WAIVER: MORTGAGOR HEREBY WAIVES ALL RIGHT UNDER THE CONSTITUTION AND LAWS OF THE UNITED STATES AND UNDER THE CONSTITUTION AND LAWS OF THE STATE OF MICHIGAN TO A HEARING PRIOR TO SALE IN CONNECTION WITH THE ABOVE-MENTIONED FORECLOSURE BY ADVERTISEMENT AND ALL NOTICE REQUIREMENTS EXCEPT AS SET FORTH IN THE MICHIGAN STATUTE PROVIDING FOR FORECLOSURE BY ADVERTISEMENT.

13. Due on Sale. If all or any part of the Property or any interest in the Property is transferred without the Mortgagee's prior written consent, the Mortgagee may, at its sole option: (a) declare the Debt to be immediately due and payable; and/or (b) deal with a successor in interest with reference to this Mortgage in the same manner as with the Mortgagor, without in any manner discharging or otherwise affecting the Mortgagor's liability under this Mortgage, or the Mortgagor's liability upon the Debt.

14. Change in Law. If the enactment or expiration of any law has the effect of either rendering this Mortgage or the Debt unenforceable according to their terms, or rendering all or part of the Debt uncollectible, or diminishing the value of the Mortgagee's security, then the Mortgagee at its sole option may declare the Debt to be immediately due and payable.

15. Miscellaneous. Any forbearance by the Mortgagee in exercising any right or remedy under this Mortgage or afforded by law or equity, shall not be a waiver of or preclude the exercise of any other right or remedy. This Mortgage shall be binding upon the Mortgagor and its successors and assigns, and any subsequent owners of the Property, and all of the covenants in this Mortgage shall inure to the benefit of the Mortgagee, its successors and assigns. This Mortgage shall be governed by the laws of the State of Michigan. If any provision of this Mortgage is in conflict with any statute or rule of law or is otherwise unenforceable for any reason whatsoever, then such provision shall be deemed null and void to the extent of such conflict or unenforceability and shall be deemed severable from but shall not invalidate any other provisions of this Mortgage. Any default by the Mortgagor under the terms of any other agreement with the Mortgagee, shall be a default under this Mortgage. The headings in this Mortgage are for convenience of reference and shall not limit or affect the meaning. In the event of foreclosure of this Mortgage or the enforcement by the Mortgagee of any other rights and remedies under this Mortgage, the Mortgagor waives any right available in respect to marshaling of assets which secure the Debt or to require the Mortgagees to pursue its remedies against any other such assets. Upon the request of the Mortgagee, the Mortgagor shall execute, acknowledge and deliver any and all such further conveyances, documents, mortgages and assurances, and do or cause to be done all such further acts, as the Mortgagee may reasonably require to confirm and protect the lien of this Mortgage.

IN WITNESS WHEREOF, the Mortgagor has duly signed this Mortgage, effective as of the date specified in Paragraph (1) above.

MORTGAGORS/BUYERS:

STATE OF MICHIGAN)
) ss.
COUNTY OF _____)

The foregoing instrument was acknowledged before me this ___ day of _____, 200__ by _____ and _____, husband and wife.

Notary Public
_____ County, Michigan
My Commission Expires: _____

This instrument drafted by
and after recording return to:

**Exhibit A
to Purchase Money Mortgage**

LEGAL DESCRIPTION

EXHIBIT D
PURCHASE MONEY NOTE

FOR VALUE RECEIVED, _____ and _____ (the "Payors") jointly and severally promise to pay to the order of _____ and _____, husband and wife (the "Payees"), the principal sum of _____ Dollars (\$_____) in accordance with the terms set forth below.

The principal shall bear interest at a rate equal to _____ percent (____%) per annum, and the Payors shall make monthly payments of principal and interest in the amount of \$_____ on the _____ day of each month commencing on _____ and on the _____ day of each month thereafter until _____, when the entire balance shall be due and payable. All principal and accrued interest may be paid on this Note at any time prior to maturity. After maturity, this Note shall bear interest at a rate equal to the rate of _____ percent (____%) per annum (but in no event in excess of the maximum rate permitted by law).

Principal and interest shall be paid to Payees at _____, or such other place as they may designate in writing.

The note evidences the balance of the purchase price of certain property conveyed by the Payees to the Payors of even date herewith and is secured by a Purchase Money Mortgage on such property.

In the event the Payors become 15 days in default under this Note or the Mortgage, at the election of the Payees and without notice to Payors, this Note shall mature and the Payees may accelerate the entire indebtedness evidenced hereby.

Each Payor severally waives demand, presentment, notice of dishonor and protest of this Note and consents to any forbearance, extension or postponement of the terms of the obligation represented hereby, to any substitution, exchange or release of any collateral securing this Note, to the addition of any party hereto, and to the release or discharge, or suspension of any rights and remedies against, any person who may be liable hereon. No delay on the part of the Payees in the exercise of any right or remedy shall operate as a waiver thereof, no single or partial exercise by the Payees of any right or remedy shall preclude any other or further exercise thereof or the exercise of any other right or remedy, and no waiver or indulgence by the Payees of any default shall be effective unless in writing and signed by the Payees, nor shall a waiver on one occasion be construed as a bar to or waiver of any such right on any future occasion.

In the event that the Payors default under the provisions of this Note and the Payees hereof incur legal expense to enforce their rights upon such default, the Payors agree that the Payees' reasonable attorneys' fees shall be added to, and shall become a part of, the principal debt owed by the Payors to the Payees hereof. The Payors acknowledge that such attorneys' fees are an obligation under this Note and not costs to be taxed or awarded in the court of litigation.

The Payors, after consulting or having had the opportunity to consult with counsel, knowingly, voluntarily and intentionally waive any right to a trial by jury in any litigation based upon or arising out of this Note or any related instrument or agreement or any of the transactions contemplated by this Note or any course of conduct, dealing, statements, whether oral or written, or action. The Payors shall not seek to consolidate, by counterclaim or otherwise, any such action in which a jury trial has been waived with any other action in which a jury trial cannot be or has not been waived. These provisions shall not be deemed to have been modified in any respect or relinquished by the Payees hereof except by a written instrument signed by the Payees.

Executed and delivered as of the date written below.

Date: _____

**EXHIBIT E
SAMPLE OPTION CLAUSE FOR INSERTION IN LEASE**

Landlord hereby grants Tenant the option to purchase the Property (the “Option to Purchase”) for a total purchase price of _____ (\$_____) (the “Purchase Price”) by providing notice of the exercise of the Option to Purchase during the term of this Lease (the “Option Period”). The terms of the Option to Purchase shall be as follows:

a. Within fourteen (14) days of the Commencement Date, Tenant shall obtain a commitment for an owner’s policy of title insurance with standard exceptions for the amount of the Purchase Price. Upon receipt of the commitment, Tenant shall notify Landlord of any objections to the condition of the title, including any conditions reflected in the commitment which render title unmarketable, within fourteen (14) days of receipt, and thereafter, Landlord shall have thirty (30) days to cure any such defects. If Tenant’s objections to the condition of the title are not timely cured, Tenant may either: (i) terminate the Lease and receive a refund of the Earnest Money; or (ii) waive his objections. In the event the Option to Purchase is exercised, Landlord shall provide, at its expense a policy of title insurance in the amount of the Purchase Price pursuant to the commitment approved by Tenant pursuant to this Section. If Tenant exercises its Option to Purchase, any objection to condition of title, including any conditions reflected in the commitment which may render title unmarketable, shall be deemed waived by Tenant.

b. Tenant may exercise the Option by delivering to Landlord written notice of its intent to exercise the Option to Purchase during the term hereof.

c. Upon exercise of the Option to Purchase, Landlord and Tenant shall close the transaction within _____ days thereafter.

d. Upon closing of the sale of the Property, Landlord shall convey fee simple title to Tenant by a warranty deed in recordable form.

e. Upon closing of the sale of the Property, Landlord shall pay all county and state transfer taxes associated with the conveyance. Tenant shall pay the cost of recording the warranty deed. Landlord and Tenant will share equally the title company’s closing costs.

f. One hundred (100%) percent of the divisions available under Section 108 of the Land Division Act are to be transferred by Landlord to Tenant upon closing after Tenant’s exercise of the Option to Purchase. Landlord makes no representations as to the number of divisions available.

g. Tenant shall have no right to exercise its Option to Purchase if it is in

default under the terms of this Lease during the period of time permitted for exercise of the Option to Purchase until it cures any such default during the period for exercise of its Option to Purchase.

h. Tenant shall not have the right to assign its interest in the Option to Purchase without the Landlord's prior written consent.

i. Landlord agrees that at the request of Tenant, it shall execute a Memorandum of Option Agreement which shall evidence Tenant's Option to Purchase, which shall be in recordable form and may be recorded by Tenant with the Register of Deeds for the County of _____.

EXHIBIT F

MEMORANDUM OF OPTION AGREEMENT

THIS MEMORANDUM OF OPTION is made and entered into as of the _____ day of _____ 200__, between _____, a Michigan _____, whose address is _____ ("Optionor"), and _____, a Michigan _____, the address of which is _____ ("Optionee").

WITNESSETH:

For valuable consideration, Optionor has granted to Optionee an option, commencing on the date hereof (the "Commencement Date") and expiring on _____ (the "Expiration Date"), to purchase a certain parcel of land situated in the Township of _____, _____ County, Michigan, more specifically described in Exhibit 1 attached hereto (the "Property"), pursuant to the terms of a certain option agreement dated this date between the parties hereto (the "Option Agreement").

This instrument is executed for the purpose of giving public record of the fact of the execution of the Option Agreement and all the terms and conditions of the Option Agreement are incorporated herein by reference, and any reference to the Option Agreement may be made by referring to the Liber and Page in which this Memorandum of Option Agreement is recorded in the office of the Register of Deeds of _____ County, Michigan.

IN WITNESS WHEREOF, the parties hereto have executed this Memorandum of Option Agreement as of the day and year first above written.

OPTIONOR:

By: _____
Its: _____

STATE OF MICHIGAN)

**Exhibit A
to Memorandum of Option Agreement**

LEGAL DESCRIPTION

CONTRACT ISSUES ON FORECLOSED PROPERTIES

While real estate and contract law has not changed due to the foreclosure crisis, certainly the processes by which foreclosed properties are sold can involve new legal issues which never arose in conventional transactions – *i.e.*, where buyers borrowed money and purchased a home from a seller that occupied the property. This article will cover some of those issues.

LENDER ADDENDUMS

Many REALTORS® represent any number of prospective buyers who are looking for the ultimate bargain in the purchase of a home. Typically, the targets of these prospective buyers end up being foreclosed properties, *i.e.*, properties now owned by a bank. Most REALTORS® are aware of the practical problems when dealing with bank-owned properties. Most prospective buyers are not. This is particularly true with first-time home buyers. Thus, REALTORS® working with first-time home buyers seeking to purchase a bank-owned property must be sensitive to the anticipated addendum or counterproposal that a bank will submit in response to any offer and, as importantly, must prepare their first-time home buyers for this document.

There is no “typical” bank addendum or counterproposal to an offer on bank-owned property, but there are some common provisions. First, the bank’s counterproposal will typically provide that there will be no seller concessions or that there will be extremely limited seller concessions with respect to closing costs and required repairs.

Second, the counterproposal may contain a provision in which the buyer is required to acknowledge that the seller may receive offers after the receipt of the buyer’s offer and may accept or reject any such offer in its sole discretion. All of this appears reasonable on its face, except that certain lenders interpret these provisions as permitting the lender to accept the buyers’ offer, but thereafter, terminate that offer if it receives a better offer prior to closing. Obviously, this type of provision has to be closely flyspecked by the buyers’ agent.

Third, the counterproposal may contain a provision stating that because the property was obtained through foreclosure or a deed in lieu of foreclosure, the purchase agreement with the buyers may be subject to approval by a private mortgage insurer or a re-purchase of the property by a prior mortgage servicer or insurer. Again, if this provision is in the counterproposal, the buyers must be made aware of the fact that their binding purchase agreement with the seller could be terminated up to the date of closing.

Fourth, the counterproposal may contain a provision that the buyers agree to accept the property in its “as is” condition at the time of closing. Again, this looks like a perfectly reasonable provision. However, many lenders interpret this provision as shifting the risk for the condition of the property to the buyers from the time of the execution of the counterproposal. In other words, if between the time the buyers accept the counterproposal and closing, the pipes in the home burst and there is substantial water damage, the damage would be deemed the responsibility of the buyers who would be required to accept the property in its damaged condition.

Fifth, the counterproposal may contain a provision that if the property has been

winterized, it will be the responsibility of the buyers, at their expense, to have the property dewatered by a licensed plumber for the purposes of the buyers' inspections. The inspection provision typically goes on to provide that the buyers will fully indemnify and hold the seller harmless from any and all claims for damages arising from inspections made by the buyers. Again, this provision appears reasonable until a home is dewatered for purposes of an inspection and there are various leaks in the plumbing and substantial water damage to the property.

Sixth, the counterproposal may contain a provision regarding negative sale proceeds. In other words, if unforeseen judgment liens or assessments result in negative sale proceeds to the seller, the seller reserves the right to cancel the purchase agreement and return any earnest money deposits to the buyers. This provision is the flip side of the usual marketable title provision, *i.e.*, a seller will take whatever appropriate steps are necessary to provide marketable title, regardless of whether it results in net negative sale proceeds.

Seventh, the counterproposal may contain a tax proration provision that benefits the lender, which is inconsistent with the local practice and the method that is set forth in the purchase offer. Obviously, the counterproposal will supersede the tax proration provisions in the purchase offer.

Eighth, the counterproposal may contain a provision stating that the seller will deliver insurable title and will pay for a buyer's policy of title insurance from a named title insurer. The buyers are usually also offered the right to purchase title insurance from a different title company at their own expense. The counterproposal typically does not specify the type of title insurance that will be provided to the buyer. Thus, some buyers receive title commitments from these seller/lenders that are nothing more than a title search from the date of the foreclosure sale or a title commitment for title insurance subject to all encumbrances whether of record or not. In other words, the buyers will not receive title insurance anything like what we have traditionally seen.

Finally, the counterproposal may address the issue of the total amount of commissions which may be paid on the transaction and the computation of those commissions. For example, the provision may cap all commissions at six percent (6%) of the net purchase price. The net purchase price would be the net of any and all seller concessions. In turn, seller's concessions could include closing costs, lender required repairs, the cost of any home warranty and the cost of any other negotiated repairs with the buyers. The buyers' agent will want to scrutinize this provision very closely.

Unfortunately, the dynamic of preparing and presenting an offer and acceptance of the offer by the seller/lender does not always result in close scrutiny of a counterproposal. The buyers' agent and the buyers have spent a great deal of time preparing the purchase agreement and are satisfied with its terms. However, a failure to understand the interaction between the purchase agreement, counterproposal and any subsequent addenda can result in substantial disagreements and failed closings.

Hopefully, the following hypothetical will demonstrate the potential problem. Assume that REALTOR® Brown is acting as a buyers' agent for the Smiths. REALTOR® Brown prepared an offer for the Smiths to purchase the bank-owned property located at 123 Elm

Street. The property has been vacant for a substantial period of time and it is extremely important to the Smiths that they have an inspection contingency and that any necessary repairs be paid for by the lender/seller.

REALTOR® Brown submits the offer to the listing REALTOR®. It is “accepted” by the lender/seller, subject to the buyers’ acceptance of the bank’s standard form “counterproposal.” The Smiths, who are excited about purchasing 123 Elm Street, quickly review (or don’t review) the “counterproposal” and sign it.

REALTOR® Brown then arranges for an inspection of 123 Elm Street by an inspector selected by the Smiths. The property must be dewatered for the inspection. The Smiths use a licensed plumber to dewater the property in anticipation of the inspection. When the inspector appears at the property, there is water damage from several leaks in the plumbing within the home. The Smiths obtain an estimate from the plumber for the necessary repairs. REALTOR® Brown prepares an addendum which describes the problems caused by the leaks and calls for the seller to pay \$1,500 to repair the leaks. The seller accepts the addendum. The plumber undertakes the repairs and the \$1,500 cost is reflected in the HUD-1 settlement statement.

The night before the closing, the seller/lender advises that it will not pay the plumbing costs which the Smiths believe that it expressly agreed to pay in the addendum. The seller/lender advises further that it will not close unless the plumbing costs are removed from the HUD-1 settlement statement. Could there be any legal justification for the seller’s refusal to do exactly as it agreed to do in the addendum? Unfortunately, in a similar situation reviewed very recently this author, there was.

In the actual transaction, when signing the addendum, the lender/seller had used a very small stamp above its signature which stated “subject to seller’s counterproposal.” The stamp was so small that it is hardly noticeable. The “counterproposal” referenced was the counterproposal previously provided by the seller/lender, which expressly provided that the seller will make no repairs to the property prior to closing. Since the addendum was signed “subject to the counterproposal,” the terms of the counterproposal controlled. By making the “acceptance” of the addendum “subject to the counterproposal” the seller/lender in effect negated the whole purpose of the addendum itself – *i.e.*, that the seller be required to pay for the repairs listed. While the actions of the seller do not appear either honorable or ethical, they certainly appear to be legal. In many instances, the listing REALTOR® and cooperating REALTOR® end up picking up the costs in these types of situations in order to complete the closing.

In sum, buyers submitting offers on foreclosed properties should be made aware of the fact that a counterproposal will almost certainly be forthcoming from the seller. The counterproposal must be closely scrutinized by buyers and their buyers’ agent. Further, if there are subsequent developments by which the buyers wish to change the terms of the purchase agreement, any addendum prepared on their behalf must clearly modify the existing contract. When a buyers’ agent receives an “accepted” addendum back from a seller/lender, the agent should examine the addendum very carefully and make certain that there has been no language change and that the “acceptance” is not made “subject to” any other document.

NEW FEES AT CLOSING: A CONTROVERSY

Based upon calls to the MAR Legal Hotline and information received by our office, it is apparent that there is a continuing controversy as to when a buyer or a selling REALTOR® may be compelled to pay a fee to the listing REALTOR® at closing. While I have tried to address this issue in the recent past, it is apparent that the information is not getting out.

The issue of whether a buyer or selling REALTOR® must pay a fee to a listing REALTOR® generally comes up in one of three different factual scenarios.

In the first scenario, the selling REALTOR® submits an offer to the listing REALTOR®. The listing REALTOR® then tenders back a counteroffer that includes a provision stating that the buyer will pay the listing REALTOR® a fee of “x” dollars at closing. If the buyer accepts the counteroffer, then the buyer is obligated to pay the fee to the listing REALTOR® at closing. As a side note, we have not yet run into the situation where the counteroffer signed by the buyer requires the buyer’s agent to pay the listing REALTOR® a fee at closing. If this situation should arise, a strong argument could be made that the buyer would not have the legal authority to bind the buyer’s agent to pay a fee to the listing REALTOR®.

In the second scenario, an offer is submitted on a property and an addendum is delivered back to the selling REALTOR®, which requires either the buyer or the selling REALTOR® to agree to pay the listing REALTOR® a fee at closing. The addendum typically requires only the signatures of the buyer and the selling REALTOR®. Further, in many instances, the execution of the addendum by the buyer and the selling REALTOR® becomes a condition for the listing REALTOR® to submit the offer to the seller. If the buyer and the selling REALTOR® sign the addendum, then they are legally bound to pay the fee at closing pursuant to the terms of the addendum. The addendum need not be signed by the seller or the listing REALTOR® for it to be enforceable.

Many times the selling REALTOR® is of the belief that the seller has not authorized, and is unaware, of the requirement that the addendum be signed as a condition to an offer being submitted to the seller. Hopefully, this is never the case, but if it is, then there are both ethical and licensing issues.

Standard of Practice 1-6 of NAR’s Code of Ethics provides:

REALTORS® shall submit offers and counter-offers objectively and as quickly as possible.

Administrative Rule 339.22307(2) provides:

A licensee shall promptly deliver all written offers to purchase to the seller upon receipt.

Assuming the listing REALTOR® will not present the offer to the seller until the addendum is signed by the buyer and selling REALTOR®, it seems fair to assume that there will be some delay in the presentation of the offer to the seller. If the seller has, in fact, authorized the listing REALTOR® to impose this fee upon the buyer as a condition of

submitting offers to the seller, then a strong argument could be made that no delay has occurred in violation of either the Code of Ethics or the Administrative Rules. On the other hand, if the seller has not authorized the listing REALTOR® to impose a fee or to withhold offers from the seller until the buyer or selling REALTOR® agrees to the fee, then the delay caused by the listing REALTOR®'s insistence upon execution of the addendum could become the basis for an ethics complaint and/or a complaint with the Department of Energy, Labor and Economic Growth. The easiest way for a listing REALTOR® to protect himself from these claims is to enter into a listing agreement with the seller which specifically authorizes the listing REALTOR® to impose the fee and to withhold the presentation of offers to the seller until the buyer and selling REALTOR® sign the addendum agreeing to the fee.

It should also be noted that a court could easily conclude that the imposition of the additional fee on the buyer or selling REALTOR® could make a property less attractive and more difficult to market. If the attempt to impose the fee was done without the knowledge or consent of the seller and the imposition of the fee was shown to materially affect the marketability of the property, a court could then conclude that the listing REALTOR® had breached its fiduciary duty to the seller.

Finally, the third scenario occurs when a listing REALTOR® places a comment in the private remarks section of the MLS stating that the "buyer shall be required to pay listing broker a processing fee of \$250 at closing." Ultimately, a buyer is procured for the property and at closing is presented with a settlement statement that indicates the buyer shall pay the listing broker \$250. The buyer then refuses to pay the \$250, as he/she did not know of any obligation to the listing broker. In this scenario, the buyer has absolutely no obligation to pay the fee to the listing broker as he/she has not agreed to do so by way of counteroffer, addendum or other document.

As a final note, we have been advised that on occasion, listing REALTORS® have demanded that a buyer or a selling REALTOR® pay a fee to the listing REALTOR® at closing by reason of the fact that in the listing agreement the seller has agreed that the listing REALTOR® may charge such a fee. In this situation, the buyer and selling REALTOR® would have absolutely no obligation to pay the listing REALTOR® a fee at closing, as neither the buyer nor the selling REALTOR® is a party to the listing agreement.

MULTIPLE OFFERS REVISITED

As part of last year's legal update, we briefly touched on the practice of multiple offers being submitted to sellers' lenders in the context of a short sale. Since that time, this practice has expanded and taken on different forms. Thus, we are briefly revisiting the subject.

The practice of submitting multiple offers to a seller's lender has taken on three basic forms. First, as offers are submitted to a seller, the seller accepts the offer by signing it with a counter that the agreement is subject to the seller's lender's approval. The seller may sign and accept any number of offers, all of which are then submitted to the lender. Assuming that a seller has accepted four offers subject to the seller's lender's approval, the seller has entered into four (4) binding purchase agreements for the sale of its property. Obviously, the seller cannot sell the property to four different buyers. The seller is counting on its lender to

approve the “best offer” with the resulting failure of the other three (3) purchase agreements due to non-approval by the seller’s lender. If the seller’s reliance on the lender approving only one of the accepted offers is misplaced, the seller would be put in the position of being legally required to sell its home to two or more buyers. Moreover, if a seller chooses to sign multiple offers for its lender’s review, at a minimum, each offer should be drafted to put the prospective buyer on notice that this may occur.

The second scenario occurs when a listing REALTOR® receives several offers on the same property. The seller does not execute the offers, but instead tenders each offer to the seller’s lender to obtain its approval prior to the seller signing any of the offers. The use of this procedure eliminates any risk that the seller inadvertently approved more than two offers and, thus, legally obligating the seller to sell its property to two or more buyers. Unfortunately, this advantage is offset by the basic problem that there is no binding purchase agreement with any of the buyers. The buyers may revoke their offer at any time and walk away from the transaction.

Finally, there are REALTORS® who deal with multiple short sale offers on the same property by treating them as they would multiple offers in a conventional market. The seller initially accepts an offer subject to the seller’s lender’s approval. Any offers thereafter accepted by the seller are accepted as properly documented backup offers. From the seller’s perspective, these backup offers should include the terms permitting the seller to amend any prior existing agreement without triggering any backup offer. From a buyer’s perspective, these backup offers should contain a date when the buyer can decide he is tired of waiting, declare the transaction at an end and receive the return of the earnest money deposit. Legally, this last method minimizes the legal risks to a seller in accepting multiple offers.

The present foreclosure glut and the sometimes unorthodox transactions caused by short sales have not changed the law of contracts. Multiple offers handled in the context of a short sale should be handled in the same way multiple offers are handled in a conventional market.

CONCLUSION

While contract law is no different for REO’s than for other properties, the provisions in the contracts themselves are often very different. REALTORS® need to keep this in mind when reviewing “counterproposal” forms presented on behalf of lender/sellers.

FORECLOSURES AND SHORT SALES – CURRENT ISSUES

MAR, in conjunction with NAR, the State of Michigan and other organizations have attempted to provide resources to both REALTORS® and members of the public to help them make their way through the current glut of foreclosures and short sales. This article is designed to address the most current issues with respect to foreclosures and short sales in a continuing effort to keep our members informed.

THE STORY

Over the past six months, this author has received numerous calls virtually every week, involving the same scenario. The response could literally be scripted and recorded and used as a sedative for harried REALTORS® and scared sellers. When provided with an understanding of their situation, the sellers are no less financially troubled, but are relieved that they now understand their situation and the possible outcomes.

The callers advise that they can no longer afford their mortgage for any number of reasons, *e.g.*, job loss, divorce, re-setting of an ARM, etc. They are certain that their home has a value which is far less than the balance on their existing mortgages, *e.g.*, \$320,000 total mortgage debt on a home valued at \$280,000. They could list their property for sale, but they have very little hope of finding a buyer in the near future. Further, while they have some money in the bank, they do not wish to keep plowing it into their mortgage, but instead want to use these funds to start over somewhere. They are still current on their present mortgage. They have tried to deal with their lender for an “Obama modification,” but have gotten nowhere. They are looking for guidance as they simply do not understand what could happen to them over the next several months.

The first thing to do is to confirm that the caller is not currently in the foreclosure process. It can then be explained to the caller that there is no immediate emergency – *i.e.*, that the caller’s family will not be out on the street tomorrow. It should be explained to callers that typically, if they quit making payments on their mortgage, their lender will not begin the foreclosure process until the third month of non-payment, at the earliest. Thereafter, the lender must publish a notice of foreclosure in a countywide newspaper for four (4) weeks. The foreclosure sale will be held at the county courthouse on the fifth week. Thereafter, assuming they are living in their house, they will have a six month redemption period. Callers are usually relieved to learn that even if they do not make another mortgage payment, they may stay in their house for at least nine months. (If a caller indicates that his house is situated on more than three acres, the caller is even more astounded to learn that his family may remain in their home without paying the lender anything for at least fifteen (15) months, as their redemption period is one year.)

Callers typically then want to know what a “short sale” is and whether they should try to do a short sale. The concept of a short sale is explained to them very simply. A buyer is obtained for the property and the lender agrees to accept less than the full amount of the indebtedness owed to the lender. If there are second and third mortgages, those lenders will also have to be satisfied in order to obtain discharges of their mortgages. If the short sale

is pre-foreclosure, then the sellers/borrowers will want to be certain to obtain a statement from their lenders that as part of the short sale, the lender is waiving any claims against the sellers for the difference in the amount of the loan and the amount being paid to the lender at closing.

Callers often ask whether it is better to enter into a pre-foreclosure short sale or wait and try to put together a short sale after the foreclosure sale during the redemption period. Callers are advised that as long as the short sale is handled correctly, it should not make a difference. If the short sale is pre-foreclosure, the seller/borrower should require a full written release from any further liability for the loan. This has the same affect as the "Full Bid Credit Rule" discussed below. If the short sale is after the foreclosure sale, the borrowers will not incur new liability unless they make the mistake of signing a new promissory note or other obligation to the lender for the difference. This should never occur.

Callers are further advised that it will be difficult for them to arrange a short sale if they have money in the bank and/or other assets, such as other real estate. If a caller has \$20,000 in the bank, he is advised that it is unlikely that the lender is going to take a haircut on their loan and let the caller walk away with \$20,000 in cash. It should be noted that this is a relatively recent phenomenon in short sales. Early in the wave of foreclosures, sellers were so underwater that they simply had no assets to try to worry about preserving. Now, many of the people facing foreclosure still have decent paying jobs and some money in the bank. Typically, when callers learn that they may have to give up all or a portion of the money they have in the bank, they seek other alternatives.

Callers then ask what their liability will be to their lender if, in fact, their property proceeds to foreclosure. They do not want to spend the next several months staying up at night worrying about being sued by their lender. Callers are advised that they will know at the time of the foreclosure sale whether they will have any future liability to their lender.

It is explained that Michigan has the so-called "Full Credit Bid Rule." When the foreclosure sale occurs, the lender is typically the only bidder who appears at the foreclosure sale and "bids the debt." When a lender bids at a foreclosure sale, it is not required to pay cash, but rather is permitted to make a credit bid because any cash tendered would be returned to it. In other words, the lender is not required to write a check to itself. *New Freedom Mortgage Corporation v Globe Mortgage Corporation*, Court of Appeals Docket No. 274864 (August 5, 2008). If the lender's bid is equal to the unpaid principal and interest on the mortgage, plus the cost of foreclosure, in Michigan this is known as a "full credit bid." When a lender makes a full credit bid, the mortgage debt is satisfied, and the mortgage is extinguished. *Bank of Three Oaks v Lakefront Props*, 178 Mich App 551, 555; 444 NW2d 217, 219 (1989). Thus, callers are advised that if a foreclosure sale occurs, they need only look at the amount stated in the notice of foreclosure published by their lender and the amount stated in the sheriff's deed of foreclosure to determine if there is any possibility of a deficiency. If their loan was \$200,000 and the lender bid roughly \$200,000, then they can live through the redemption period without any worry that they will owe the lender additional amounts on their loan. If the amount in the notice of foreclosure was \$200,000 and the sheriff's deed indicates that the lender bid \$180,000, they will know that their outside liability to the lender for the loan is

\$20,000, plus interest. Typically, the caller is both surprised and comforted by this information.

The caller then asks whether if there is a deficiency after the foreclosure sale, the lender can immediately take the \$20,000 in savings that the caller has in another bank. Callers are further relieved to learn that to pursue them for a deficiency, their lender must do more than simply bid less than the amount owed at the foreclosure sale. The lender must start a legal action against them and sue them for the deficiency. If a homeowner believes his house is worth more than the lender bid, he can assert a defense to the litigation by providing an expert appraiser who will establish that the property was worth some amount more than the amount bid by the lender. MCL 600.3290. In the meantime, callers are advised that they can use their savings in their bank as they please. Typically, they are again astonished that they could use their savings to buy another piece of property on land contract or a purchase money mortgage or through a lease with an option to purchase. Alternatively, they could take their savings and spend a very big weekend in Las Vegas. The point is that the lender cannot simply seize their money after there is a deficiency at the foreclosure sale.

Finally, to round out the picture, callers are advised that they may wish to reach an agreement with their lender to provide a deed in lieu of foreclosure. In this situation, they would give up their right to occupy their home for “free” during the redemption period by providing a deed in lieu and the keys to their home to their lender. In turn, the lender would give up any potential claim for a deficiency.

Almost always, the conversation ends with the caller in much better spirits. The caller now knows that he is not going to immediately lose his home, that there are options available to him and that his family can use their savings to get on with their life.

The high anxiety is attributable to misinformation published in the press, unknowledgeable “friends” and out-of-state lenders who do not understand Michigan law. The callers have previously been advised that if their house proceeds through foreclosure, the lender takes legal title and thereafter sells it for an amount less than the indebtedness owed to the lender, the lender can come back and sue them for the difference between the amount of their indebtedness and the price obtained by the lender when it sold their home. In other words, if the lender was owed \$200,000 and sold their home after foreclosure for \$100,000, they would immediately be liable to lender for \$100,000. This is simply not true. The sooner that homeowners in trouble are told this story, the lower their anxiety level and the greater likelihood that they will be in a position to make an informed choice as to the options available to them.

PROTECTING TENANTS AT FORECLOSURE ACT OF 2009

The federal government has enacted a new law aimed at protecting tenants of foreclosed homes. Generally, the new foreclosure law provides that in certain circumstances, a residential lease will survive a foreclosure. Specifically, this law provides that after a foreclosure, the lender (or other purchaser at the foreclosure sale) must give tenants at least 90 days notice to vacate the home. Moreover, if the tenants have a “bona fide” lease, the tenants have the right to stay in the home for the remaining term of their lease unless the new owner intends to occupy the home. The law applies only in the case of “federally related”

mortgages (*i.e.*, almost all of them). A “bona fide” lease is a true lease to a non-relative, at fair market rent, entered into prior to the foreclosure sale notice. The legislation has a December 31, 2012 sunset date.

MICHIGAN FORECLOSURE STATUTE AMENDMENTS

Michigan has enacted new legislation that applies in the case of the foreclosure of a principal residence (based upon the homestead exemption). Under this new law, prior to foreclosing, the lender must send a written notice to the borrowers advising them that they have an opportunity to meet with the lender’s designated representative and attempt to come up with a modification plan. The notice is also to include a list of housing counselors prepared by MSHDA (Michigan State Housing Development Authority), the State Bar’s lawyer referral service telephone number, as well as the telephone number of the local legal aid office. The notice is to be sent regular mail, certified mail and published.

The borrower has 14 days to opt in to the loan modification process by requesting a meeting through a housing counselor. The lender’s designated person may request that the borrower provide financial documents. If the borrower chooses to participate in the loan modification process, the foreclosure process is delayed for 90 days to allow time for workout discussions. A lender is not required to modify any loan; however, if a borrower who participates in the program meets certain financial criteria and no resolution is reached, the lender can still foreclose, but must proceed through the judicial foreclosure process, which is a much slower process. If there is a default on a loan that has been modified pursuant to this process, the lender need not repeat the process unless more than a year has lapsed. These new provisions have a 2-year sunset.

FORECLOSURE SHORT SALE AND CREDIT RATING

An often-posed question is why does a seller engage in a short sale? One of the most often stated reasons is a belief that a short sale will do less damage to a credit rating than a complete foreclosure sale. We have often stayed away from trying to answer this question inasmuch as each individual’s credit is based upon a number of factors above and beyond the status of their home loan. However, there is some guidance that can be provided to sellers who are considering a short sale or foreclosure.

Fannie Mae Announcement 08-16 (“Announcement”) provided updates to its underwriting requirements for borrowers with foreclosure actions in their credit history. These foreclosure actions include deeds in lieu of foreclosure and pre-foreclosure sales.

Fannie Mae’s policies provide that the time period that must lapse before borrowers can demonstrate that they have re-established an acceptable credit history (the “Waiting Period”) in the case of a foreclosure is five (5) years. There are also additional requirements that apply after five (5) years up to seven (7) years following the completion date of the foreclosure. For these borrowers, the purchase of a principal residence is permitted with a minimum down payment of ten percent (10%) and a minimum representative credit score of 680. Further, the qualification is for a principal residence only – the purchase of a second home or investment property is not permitted. Also limited cash-out refinances are permitted for all occupancy types pursuant to eligibility requirements in effect

at the time of the refinance. Complete cash-out refinances are not permitted for any occupancy type until the expiration of seven (7) years from the completion date of the foreclosure.

The Announcement does provide exceptions for documented extenuating circumstances as to the cause of foreclosure. A more extensive discussion of this subject is in Fannie Mae Announcement 08-08. If there are extenuating circumstances for a foreclosure, the Waiting Period is three (3) years from the date of the completion of the foreclosure process. The same additional requirements apply after three (3) years up to seven (7) years as for a foreclosure without extenuating circumstances.

In the case of a deed in lieu of foreclosure, the Waiting Period is four (4) years. There are additional requirements that apply after four (4) years up to seven (7) years. These borrowers may finance the purchase a principal residence, second home or investment property with a greater of a ten (10%) minimum down payment or the minimum down payment required for the transaction.

For deeds in lieu, as with foreclosures, there are also exceptions to the Waiting Period where there were extenuating circumstances in connection with the deed in lieu of foreclosure. Here, the current Waiting Period is two (2) years. The same additional requirements apply in the case of a deed in lieu of foreclosure, after two years up to seven (7) years following the completion date of the delivery of the deed.

Fannie Mae has also established a policy in cases where a pre-foreclosure sale occurred for the property, *i.e.* where there has been a short sale. The Waiting Period here is two (2) years. No exceptions for extenuating circumstances are permitted to the two-year time period.

The Announcement, along with Announcement 08-08, provides greater detail with respect to underwriting requirements for borrowers with prior bankruptcy or foreclosure actions in their credit history. However, the information set forth in this article does provide general guidelines. Again, each individual's credit history differs and the guidelines may not be applicable to them. For example, if in the past the individual has had multiple bankruptcies and/or prior foreclosures, their consideration by Fannie Mae may well change. Also, these guidelines only apply to Fannie Mae loans.

CAPS ON COMMISSION RATES

Unfortunately, a fairly common scenario is playing out as REALTORS® approach closings on the sale of so-called REO homes. In the typical scenario, the seller has agreed to pay a six percent (6%) commission on a modestly priced home (say \$45,000) and is offering a \$2,000 bonus to the cooperating REALTOR® who procures a buyer for the property. The buyer is found for that price and the parties proceed to closing. The HUD-1 indicates that a six percent (6%) commission of \$2,700 shall be paid, along with the \$2,000 bonus to the cooperating REALTOR®. The night before the closing, the HUD settlement statement is provided to the buyer's lender. The following day, the buyer's lender advises the listing REALTOR® that it will not approve the HUD settlement statement. The bonus of \$2,000 to the cooperating REALTOR® would cause payment of commissions in excess of eight percent (8%). The buyer's lender advises that it will not go forward with the transaction until the total

commissions, including any bonus, are reduced to eight percent (8%).

The listing REALTOR® is obviously in a difficult position. The listing broker has offered the cooperating REALTOR® a commission of three percent (3%) of the purchase price, plus a bonus of \$2,000. Unless the cooperating REALTOR® agrees to waive at least a portion of the agreed-upon commission, the listing REALTOR® arguably still has an obligation to pay the cooperating REALTOR® the full amount.

The question is posed as to whether the buyers' lender has the legal right to require a reduction in the total commissions paid. The answer is quite straightforward – the buyers' lender has the right to withhold funding of the buyers' purchase, thus, as a practical matter, preventing the closing. The question is raised as to why a buyers' lender cares about the commissions being paid to the REALTORS® in the closing. The typical reason provided is that the buyers' lender wants to make sure that the purchase price of the home has not been inflated in order to cover various fees for services. They usually further indicate that because of excess commissions, the buyers may have less equity in the transaction and thus be more prone to default on their loan.

MAR has become aware of the fact that a great number of lenders are now imposing an eight percent (8%) cap on commission in REO and other transactions. These lenders generally acknowledge that there is no state or federal mandated cap on their loans. However, at least one lender has indicated that the eight percent (8%) cap on commissions “is an industry accepted cap and a guideline that we and many of our larger institutional investors have put in place.” Their rationale for imposing the cap is to discourage or prevent artificial adjustments of a purchase price to offset allegedly excessive high REALTOR® commissions and fees. Obviously, if the eight percent (8%) cap on commissions becomes an “industry practice” or appears to be the product of an agreement among lenders, the situation could bring into play both state and federal antitrust laws. MAR will continue to monitor this situation.

CONCLUSION

Until the foreclosure glut and credit crunch comes to an end, there will continue to be new issues. MAR will strive to keep the members abreast of all new issues in this area which affect the way they practice their business.

LEGAL LIABILITY UPDATE

INTRODUCTION

Traditionally, our legal update has included a separate article discussing recent cases from elsewhere around the country. While often these cases may be distinguishable or the result would likely be different in Michigan, a discussion of these scenarios can provide a framework for understanding liability trends. This article is not a comprehensive discussion of every recent agency case, rather, the following cases have been selected for the lessons they provide.

Every home has a history, and it's not always pretty. This year's legal update presents lawsuits brought by buyers upon discovering various distressing things about the history of the home they have purchased.

DISCUSSION

In *Bloor v Fritz*, 143 Wash App 718 (2008), an agent representing both the buyers and sellers of a home was held liable to the buyers for failing to disclose that the house had previously been the site of a crystal-methamphetamine lab and marijuana-growing operation. In early January of 2004, the owners of a home located on a secluded five-acre parcel in rural Washington state rented it out to four tenants. The industrious tenants immediately set up a methamphetamine lab underneath the back deck and in the hot tub, together with a large marijuana growing facility in the basement.

A few weeks later, on January 30, the county police department's narcotics task force executed a search warrant at the property and quickly discovered all of the tenants' contraband. The police issued a press release that identified the house and revealed that the home had been the site of methamphetamine production; the details of the press release were reported in the local newspaper. However, the narcotics task force apparently neglected to inform the local health department.

One of the property owners learned of the police activity at the house and set about learning what had happened. She eventually spoke with the narcotics task force detective who helped conduct the search of the home. Through this conversation, the property owner learned the details of what had been going on in the house and she shared this information with the other owner (her husband) and their real estate agent, Robert Miller, who at that point had been acting as the owners' property manager. In February, the owners initiated eviction proceedings against the tenants, two of whom had been arrested and charged with drug crimes. The owners then had Mr. Miller list the property for sale.

Eddie and Evan Bloor moved to the area from Missouri shortly thereafter and began looking for a home to purchase. Over the summer of 2004, they began working with Robert Miller, the property owners' real estate agent, and Miller eventually showed them the property where the drug manufacturing operations had taken place. The Bloors decided to make an offer to buy the property. Robert Miller represented both the sellers and the buyers in the transaction.

One of the owners had completed a seller's disclosure statement in which he represented that the property had never been used as an illegal drug manufacturing site. When Miller reviewed that disclosure statement with the buyers, he never disclosed to them the fact that a drug task force had discovered a marijuana-growing operation and a methamphetamine lab on the property. The sellers accepted the buyers' offer and the transaction closed in August of 2004. The buyers moved into the home shortly thereafter.

In September, the buyers' son heard from a neighbor that the property was commonly known in the community as a drug house. Not surprisingly, this rumor spurred the buyers to investigate the history of the house and they quickly came upon the online version of the February local newspaper report detailing the drug raid in what had become their home. In October, the buyers called the local health department, which immediately conducted an investigation.

The health department quickly determined that the property had been extensively contaminated by the production of methamphetamine and was entirely unfit for occupancy. The health department instructed the buyers to leave immediately and told them they could not take any personal items from the home, as everything in the house had become contaminated and posed serious health hazards. They did as they were told, leaving nearly all their personal belongings behind in the house and the garage. The health department then posted an order on the house prohibiting all use of the property, stating that any use of the property was subject to criminal prosecution and that the buyers were financially responsible for the cost of remediation by a certified, professional contractor.

The buyers lived with relatives before finding a new home in a new city. They had to repurchase all of the personal items they had been forced to leave behind - clothing, bedding, furniture and other necessities. Because they were unable to bear the financial burden of making payments on the former meth lab home while paying for new accommodations elsewhere, the home was lost in foreclosure. The buyers sued the sellers, the real estate agent, Robert Miller, and Mr. Miller's real estate company.

Not surprisingly, the trial court ruled in favor of the buyers against all of the defendants. Predictably, the court found that the buyers were entitled to compensation for the loss of the personal property and the loss of their home. The trial court also found that the buyers were entitled to be compensated for their loss of income, the damage to their credit and for their emotional distress.

In finding against the real estate agent, the court relied in part on a Washington statute, which requires a real estate agent to disclose "all existing material facts known by the agent." As most Michigan REALTORS® are aware, Michigan does not have such a statutory requirement. And unlike in Michigan, Washington state's seller's disclosure form explicitly asks whether the home has ever been used as an illegal drug manufacturing site. Finally, the judge ruled that the agent's conduct violated the state of Washington's Consumer Protection Act (Michigan's Consumer Protection Act, however, does not - and hopefully never will - apply to real estate agents).

While Michigan REALTORS® would not be subject to the same statutory framework, the outcome could have been the same for a Michigan REALTOR®. The judge in this case made

a specific finding of fact – *i.e.*, that the REALTOR® had knowingly passed on false information about the home to the buyers. In light of this factual determination, a Michigan REALTOR® could be held liable under a simple common law fraud claim.

Liability for agent misrepresentations is not necessarily limited to statements about physical elements of a home. In *Biancheri v Johnson*, 2009 WL 723540 (Tenn Ct App), buyers of a home sued the sellers' real estate agent for failing to disclose that the previous resident had been shot and killed in the home. The home had belonged to a Joseph Mercer, a prominent Nashville attorney, and his wife Belinda. On April 16, 2005, the couple was in the midst of a heated argument when Belinda picked up a .22 caliber pistol. When Joseph attempted to take it from her, the gun went off and Joseph was shot through the neck. He died from the gunshot wound a short time later, before paramedics arrived. Belinda Mercer was later acquitted of second degree murder charges.

Six weeks after the shooting, the home was up for sale. Charles and Vikki Johnson were shown the home by their real estate agent. Noticing that there was still food in the refrigerator, but that all the clothes and personal items were gone, the Johnsons became curious about the previous owner of the home. Shortly thereafter, the Johnsons and their agent made independent inquiries regarding Joseph Mercer's death. Both discovered news articles on the internet that indicated that Mercer had been shot and killed inside the home. This discovery severely dampened the Johnsons' interest in purchasing the home, as Mrs. Johnson did not want to live in a home where someone had died a violent death.

However, when the Johnsons mentioned this to the sellers' agent, the sellers' agent told the Johnsons that in conversations that the agent had with the neighbors, she had learned that Mr. Mercer did not die inside the house, rather, he had died in the ambulance after being taken from the house. Apparently, the difference between a person being shot in the neck and dying in the house and being shot in the neck and dying somewhere else was, to the Johnsons, enough to tip the scales back in favor of buying the house. The parties signed a purchase agreement and scheduled a closing.

However, the day before the closing, the Johnsons discovered that Mr. Mercer had in fact actually died *inside* the house (and that certain electronic fixtures had been removed) and refused to close on the sale. The sellers sued the Johnsons for breach of contract for failing to close and the Johnsons brought suit against the sellers' agents for fraudulent and negligent misrepresentation and violations of the Tennessee Consumer Protection Act.

The Tennessee Court of Appeals held that the sellers' agent could be liable for negligent and fraudulent misrepresentation based on her statement that the previous owner had not died inside the house. The sellers' agent's defense was that it was not reasonable for the buyers to have relied on her statement regarding where the previous owner had died after being shot and that the buyers had a duty to do further investigation to determine the location of the death. The Court of Appeals, noting that the buyers had in fact done further - but ultimately unsuccessful - research and that the police investigation was still open at the time, held that the jury could very well look at the facts and conclude that the buyers reasonably relied on the misrepresentation of the sellers' agent. From this single misrepresentation about where the previous owner had died, the court held that the sellers' agent could be liable

for negligent misrepresentation, fraudulent misrepresentation and under that state's consumer protection act.

Many readers may recall that in Michigan, we have a statute that expressly provides that an agent shall have no liability for failing to disclose to a purchaser that the real property was the site of a homicide, suicide "or other occurrence prohibited by law, which had no material effect on the condition of the property." MCL 339.2518. It is not at all clear that such statute would protect an agent where, as here, the buyers had specifically asked about the incident.

Finally, it is certainly true that there was no evidence that in this case that the agent had known her statement was false. Likewise, it is certainly true that in Michigan, seller's agents are not liable for innocent misrepresentations made to buyers. But remember that here the statement was made in response to stated concerns presumably to assuage those concerns. In Michigan, a person can be held liable for actual fraud based upon a statement made "recklessly, without any knowledge of its truth and as a positive assertion."

In the last case, *Waddles v LaCour*, 950 So2d 937(LA App 3 Cir, 2007), the buyer sued a real estate agent who had represented both the buyer and the seller when the buyer discovered that the house he purchased had once been a mobile home. The LaCours listed their home on ten acres in Louisiana for sale with a real estate agent. While the property was listed for sale, the agent received three separate calls from neighbors, telling her that there once was a mobile home on the property where the house was located. The agent claimed that she had asked the sellers about each one of the calls and that the sellers repeatedly told her that there *had* been a mobile home on the property when they bought the land, but that the mobile home was now gone. The agent testified that each call had raised her suspicions but that she believed the sellers when they assured her that the mobile home was **Agone@**.

Jerry Waddles, who had lived in Colorado for the previous thirty years, came to Louisiana to buy a home to retire in. Waddles drove by the home, immediately called the real estate agent, and was shown the property that same day. Waddles was scheduled to leave town the following day, so he signed a dual agency agreement with the agent as well as a purchase agreement for the property - only hours after first seeing the home. The agent never informed the buyer before the sale that she had received any phone calls related to there having been a mobile home on the spot where the house was now located.

After moving into the home, the buyer got a phone call from a neighbor and the neighbor told him that his house had once been a mobile home. A short time later, a second neighbor called and told him the same thing. The buyer ignored these calls until *a third* person called and told the same story. At that point, the buyer relayed those statements to the real estate agent. Only then did the agent reveal to the buyer that she had received similar calls while the home was listed for sale.

After the buyer received the three calls from his neighbors, he hired a home inspector. The inspector found that the house was a combination of a site built home *and* a mobile home. The home had been built around the existing mobile home: the inspector estimated that approximately twenty-five percent of the home consisted of mobile home components. A portion of the home consisted of the existing mobile home with added standard wall studs and

a frame had been added around the entire outer portion walls of the mobile home. This second wall hid all the entire exterior of the trailer, although the inspector was able to see the steel frame of the trailer underneath the house.

The buyer then brought a lawsuit against the sellers and the real estate agent and her partner, claiming that the agents had falsely marketed the home as a custom home and failed to disclose that the home was actually built around a mobile home. After a bench trial, the trial judge issued an opinion, the language of which can be instructive for REALTORS⁷:

[The real estate agents] seem to think they are entitled to rely on the denials of the LaCours (sellers) who filed for bankruptcy and are long gone. With one call, the court might agree; with two, it=s doubtful; but, three? Absolutely not. Any reasonable person would have become sufficiently alerted to understand that the dual agency obligation required a disclosure. Not because they believed or disbelieved the LaCours and not because they knew the incorporation of the trailer was true or untrue; the disclosure was required because the two realtors had a fiduciary obligation to the buyer *and* the seller. If it was something they had to keep asking the seller about, it was something they needed to tell the buyer. It is not up to the realtor to choose who to believe. People lie. The LaCours must have been really good at it. When the realtor chooses to believe a dishonest seller and fails to disclose, he will be liable for making a choice that was not his to make.

In finding against the agent, the Court relied at least in part on a Louisiana statute that sets forth various duties owed by a dual agent, including the duty to “provide information about the property to the buyer” and the duty to “disclose all latent material defects in the property that are known to the licensee.” In light of these statutory duties, the Court found that the agent had a duty to disclose the fact that she had received several calls that there had once been a mobile home on the property. The Court found that the decision as to whether or not to rely on the seller’s assurances should have been made by the buyer, rather than the real estate agent. The Court held that agents owed a duty to the buyer to inform him about the three phone calls so that he could have had the opportunity to question the sellers himself, had an inspection specifically to address those concerns, and had the opportunity to negotiate the deal to reflect the true nature of the home.

The trial court awarded the buyer damages to account for the reduction in the home’s value based on its status as partially-manufactured housing. The trial court also awarded the buyer \$10,000 for mental anguish, stating: **A**The feeling that you have been taken for a fool or cheated in a business deal is hard enough; but, to feel you have been cheated in the purchase of a retirement home, where you want to live out your days in pleasure and relaxation, is more personal and longer lasting.**@** The trial court’s decision was affirmed on appeal.

Unlike Louisiana, Michigan does not have a statute imposing a duty on dual agents to volunteer information about a property. Rather, the duties are left to the specific contract

between the parties. Most Michigan forms provide that in the case of dual agency, the seller and buyer are giving up their rights to undivided loyalty and will be owed only limited duties of disclosure. But remember that here the agent had marketed the home as a custom home and that the agent had received three separate calls suggesting that this was not true. Faced with such facts, a Michigan court could very well conclude that the agent had committed fraud by passing on information that she knew was false.

CONCLUSION

All of the cases discussed in this article involved buyers who subsequently discovered negative facts about the home that they had purchased or almost purchased. In all three cases, the agents were found liable based upon statutes that we do not have in Michigan. Even in the absence of such statutes, these cases could have very easily come out the same way in Michigan under an actual fraud theory. In Michigan, actual fraud covers both knowingly passing on false information as well as making what appears to be an authoritative response to a question without any real knowledge as to the actual facts.