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## WHEN WILL THE HOUSING MARKET GET BETTER? PROBABLY NOT ANYTIME SOON.

This is a banking and construction litigation attorney's perspective on the oft-asked question, "When is the housing market going to get better?" Although we cannot read the future (if we could, we would do nothing but buy put-options and lottery tickets), the answer seems to be, "Probably not anytime soon."

### **It Was Fun While it Lasted.**

How did the housing market get into the mess it is in now? In January 2001, the Federal Reserve Board began the first of 13 consecutive reductions in the federal funds rate (the interest rate that banks charge each other for overnight loans). That significantly reduced the cost to consumers to borrow money. As a result, homeowners were able to refinance their existing mortgages at lower interest rates. That enabled them to borrow significantly more money for the same monthly mortgage payment. At the same time, former renters rushed into the housing market because monthly mortgage payments often became as low or lower than existing monthly rent payments.

All this brought an influx of potential borrowers to the mortgage market. Lenders competed aggressively with each other to make loans, causing many lenders to reduce their underwriting standards so that they could make those lucrative loans. At the same time, there was an increased demand for condominiums and single-family residences and the economy was booming. Housing prices skyrocketed with annual appreciation in some areas of the country exceeding 20% per annum. Builders could not construct condominiums and houses fast enough.

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### **All Good Things Come to an End, or, What Goes Up Must Come Down.**

About two years ago, the housing market began to slow. The slowdown first started in less-affluent sections of large metropolitan areas, where mortgage loans made to borrowers with less-established credit (so-called “subprime” mortgages) were going into foreclosure due to nonpayment. Lenders were taking back these properties in droves and became anxious to rid themselves of these properties. At the same time, lenders began to more closely analyze whether subprime loans were really profitable due to increasing rates of default. This reduced the availability of previously easy credit to borrowers with less-established credit histories. The combination of an increased supply of homes and decreased consumer demand (due to the reduced pool of qualified candidates having satisfactory credit) caused housing prices in certain areas of the country to fall even more.

Then, more trouble hit. It turned out that the “subprime” mortgage problem (it was not yet referred to as a crisis) was not confined to less-affluent areas. Borrowers with less-established credit were purchasing homes outside of less-affluent areas, and lenders were providing them with easy financing. Additionally, lenders had made a significant amount of loans to borrowers on so-called “no documentation” mortgages: mortgages under which borrowers would pay a higher interest rate to avoid having to provide documentation verifying, among other things, their income, employment or existing assets.

Not surprisingly, many of the borrowers on no documentation loans did not have the income, job or assets that they claimed and, therefore, were unable to make the monthly payments. These loans now have their own acronym: NINJA loans, meaning *No Income and No Job or Assets*, just the kind of borrower that banks had traditionally shunned. Because many NINJA borrowers lived in affluent areas, the problem spread throughout the entire spectrum of lower, average and above-average priced homes.

Many lenders, builders and realtors believe the worst is behind us. That may be wishful thinking. Another loan product rolled out during the easy-credit explosion of the early 2000’s was an adjustable rate mortgage that had an initial lower “teaser” interest rate during the early years of the mortgage with a significant rate increase in the later years of the mortgage. The rates on these loans typically range from 2% below the prime rate during the early years of the mortgage to as much as 5% above the prime rate during the later years. That 7% swing meant a huge increase in the borrower’s monthly payments

during the term of the loan which many borrowers could not make.

Many of these borrowers knew exactly what they were doing when they took out their loans, but they assumed they would be able to refinance at a lower rate when the increased later-year rates kicked in. They were wrong. The Federal Reserve’s 13 consecutive rate reductions were followed by 17 consecutive rate increases, beginning in July 2004. The availability of lower rate refinancing dried up. Many lower “teaser” rates are now expiring. The new increased rates on many of these mortgages will be as much as 5 points higher. With no low-rate refinancing available and with the housing market in a slowdown, the mortgage defaults that were principally confined to “subprime” and “no-documentation” mortgages may further permeate the credit and housing market.

Residential foreclosures in Illinois are now running at a rate that is double the rate one year ago, an extraordinary increase. The highest foreclosure rates in the nation are now in Nevada, California and Florida, where the most speculation in the housing market was present in recent years. Once again, what goes up must come down. On this dubious list, Illinois ranks ninth.

### **The Fed Tries to Fix the Problem**

The Federal Reserve recently reversed course and instituted what could be the first of a series of reductions in the federal funds interest rate. What impact this will have on mortgage interest rates generally and on the housing market as a whole remains to be seen. The only thing that seems certain is that existing adjustable rate mortgages that are tied to the prime rate should see an immediate drop in the current interest rate.

### **What Does This Mean for You?**

How you are personally affected by the existing problems in the credit and housing markets will depend upon your personal situation. Borrowers with good credit (i.e., good payment history and verifiable income and assets) should always be able to borrow money. If you do not have to sell your home now, most experts recommend sitting back and doing nothing with the expectation that the housing market will stabilize by late-2008 or mid-2009. If you have to sell your home now, price it properly and allow yourself plenty of time to sell. It is not uncommon for even properly-priced homes to be on the market for six months or more before even one offer comes in.

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## DISTRIBUTIONS FROM EMPLOYER-SPONSORED RETIREMENT PLANS

You are an employer with a qualified retirement plan for your employees. The plan may be a profit sharing plan, a money purchase pension plan, a 401(k) plan or a defined benefit pension plan. As the employer, you have been paying annual contributions to the plan. If the plan is a 401(k) plan, the employees may also have been making their own tax-deferred contributions to the plan.

Now, an employee-participant terminates employment with you. What must you do? When an employee leaves, a distribution must be made of the employee's account balance or accrued benefit. This article will discuss the rules for distribution.

The employer must give the departing employee a special tax notice in the form prescribed by the IRS that tells the employee all information he will need to decide how to receive plan benefits. Basically, the employee has three options:

**First, the employee may elect a direct rollover of his money.** If the employee makes this election, he will not be immediately taxed on the distribution and no income tax will be withheld. As the employer, you are required to pay the account balance directly to the participant's new rollover individual retirement account (or to another employer's plan if that new employer accepts the rollover). The payment will be taxed in the future when it is distributed from the rollover IRA or the new employer's plan. If the employee receives a distribution before age 59½, there will be a 10% penalty imposed on the distribution.

**Second, the employee may elect to have the money paid directly to himself.** The participant will then be taxed on the distribution in the current year. Under this option, the participant will receive only 80% of the amount due him. That is because the employer is required to withhold 20% of the payment and forward it to the IRS as income tax withholding to be credited against the participant's taxes for that year. Again, if the employee is younger than age 59½, the amount he receives will also be subject to an additional 10% tax on top of the regular tax.

The participant electing this second option must complete a form advising you as the employer as to the name, address, and account number of the rollover IRA or the new employer's plan to which you will forward the

participant's money. This form must also include an acknowledgment by the participant that all requirements of the Internal Revenue Code have been complied with by the receiving plan or institution and that the participant has received the required information explaining the direct rollover, withholding and tax rules.

**Third, the employee may opt to postpone the decision for 60 days as to whether he will take the money or roll it over into another retirement account.** Under this option, the employer pays the money to the employee and then the employee has 60 days to decide what to do. Like the second option, the participant electing this third option will receive only 80% of the total distribution, with the remaining 20% forwarded to IRS for withholding. If the employee opts to roll over more than 80%, he must use his own funds to make up the difference.

The employee may elect to receive a series of equal periodic payments. The employee will pay tax on all amounts distributed to him. There is no penalty on distributions made to the employee before age 59½. But, all payments must be equal and determined before payments start. Often a commercial annuity is purchased to fund the payments.

The departing employee must also inform you as the employer whether he is married and the name of his spouse. That is because most plans require that the participant's spouse agree to any form of distribution. The exception is where the funds are paid to a joint and survivor annuity under which benefits are paid to the participant for his life and then to the spouse for the balance of her life.

No matter which option the employee chooses, the employer must report the distribution to the IRS. In January of the year following the distribution, the employer must send a form 1099-R stating the amount distributed, regardless of whether the employee took the money or rolled it over. If he rolled it over, the rollover IRA administrator or the new employer will notify the IRS of the rollover, thus neutralizing the 1099-R.

An employer who fails to follow these rules will be subject to penalties.

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## THE APPURTENANT EASEMENT – A VALUABLE PROPERTY RIGHT

Does your business or residential property share a common driveway or parking area with the property next door? Do you use the adjoining property for access to your property? Does your property connect to a stormwater drainage system located on the adjoining property? If the answer is yes to any of these questions, then your property may be benefited by an appurtenant easement.

An easement is the right to use someone else's land. Easements are either "appurtenant" or "in gross." An appurtenant easement benefits a specific parcel of land, known as the dominant estate. The parcel over which the easement runs is called the servient estate. An appurtenant easement attaches to the ownership of the dominant estate and runs with the land. That means if the dominant estate is sold, the appurtenant easement will pass to the new owner, and if the servient estate is sold, it will remain subject to the easement. By contrast, an easement in gross is a mere personal right and is generally not assignable. Utility easements are usually easements in gross.

### Why are Appurtenant Easements Valuable?

Appurtenant easements often provide a cost effective means for developing or enhancing the use of the dominant estate. For example, in new construction the natural topography of the land may cause stormwater runoff to drain from the dominant estate to the servient estate. In such case, it may cost significantly less to hook up to the existing stormwater drainage system located on the servient estate than to construct an independent storm sewer connection from the dominant estate into the municipality's storm sewer lines. The owner of the servient estate may be willing to grant an easement to mitigate the rate of release of stormwater runoff from the dominant estate onto the servient estate.

Appurtenant easements can be valuable to a developer of real estate to split his operation of multiple parcels which are operated as one large project. The developer creates the appurtenant easements on the applicable parcels for access, drainage, signage, landscaping, etc., which enables it to sell the parcels separately.

### Creating an Appurtenant Easement.

Appurtenant easements are usually created in an easement agreement, deed or recorded declaration affecting large residential and commercial subdivisions. Here are some basic considerations in drafting an easement agreement:

**Title Search.** A title search should be run on the servient estate to confirm ownership and existing mortgages. The owner and all existing mortgagees must consent to the easement agreement. The mortgagees must agree to subordinate their mortgages to the easement so the easement cannot later be extinguished if there is a foreclosure.

**Purpose.** The easement agreement should clearly define the specific purpose of the easement.

**Term.** Will the easement be perpetual or for a specified time limit?

**Consideration.** The agreement should identify the monetary payment or other consideration for the easement grant.

**Nature.** Will the easement be exclusive or non-exclusive? Will the easement be revocable or irrevocable?

**Construction/Maintenance.** If the easement will require construction work such as a roadway, storm sewer or drainage pipes, the agreement should specify who will perform the work and at what cost allocation between the parties. Maintenance obligations should be clearly stated with cure rights in favor of the other party if the obligated party fails to perform.

**Indemnification/Insurance.** The grantee should indemnify the grantor for any losses attributable to physical damage or personal injury associated with the grantee's use of the easement area. If the grantee will perform any work on the servient estate, the grantee should be required to have appropriate insurance insuring the grantor.

**Costs.** The agreement should specify any fees to be paid by the grantee such as a portion of real estate taxes or maintenance costs.

**Estoppel Certificates.** The easement agreement should provide for a form estoppel certificate and require each party to provide such document when requested. The agreement should state that if the estoppel certificate is not provided then the party is deemed to have agreed that the agreement is in full force and effect and that the other party is in full compliance. A potential buyer or mortgage lender will often require an estoppel certificate from the grantor of an appurtenant easement confirming its validity.

**Title Insurance.** The grantee of an appurtenant easement should be certain that his owner's title insurance policy, which insures his ownership of the dominant estate, also insures the grantee's rights in the appurtenant easement as an easement for the benefit of the dominant estate.

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## A CONTRACT WITH YOUR CHILD'S NANNY? GOOD GRIEF. WHAT'S NEXT?

You've done all the interviewing and reference checking and have finally settled on Mrs. Right to hire as your child's nanny. You think you've finally finished the tedious process, when along comes a lawyer who says: Maybe you should have a contract with the nanny. A contract? *Good grief!*

### **Do I Really Need a Nanny Contract?**

While no law requires a written contract with a nanny, a contract might be a good idea to establish the ground rules of your relationship with the nanny. Remember, your nanny will have sole charge of your children in an unsupervised setting and your family will depend on her. The nanny contract will set the professional tone of the relationship.

### **What Should the Nanny Contract Cover?**

If you decide to have a nanny contract, it should cover everything related to the nanny's job including the days and hours the nanny is expected to work; the duties she is expected to perform; the compensation to be paid as an hourly rate or a salary; benefits including paid or unpaid holidays, paid or unpaid sick days and your contributions, if any, to the nanny's medical insurance premiums; and frequency of payment.

On her part, the nanny is entitled to periodic performance appraisals. Regular salary reviews are important to keep your nanny happy and your turnover low.

Set forth in the contract your house rules such as whether the nanny may have visitors, usage of the television and telephone, smoking or alcohol prohibitions, dietary restrictions and security. For a live-in nanny, this will be more detailed, covering for example, whether the nanny may have guests after hours and whether you must meet and pre-approve the guests.

The contract should also cover special situations. If you must work late what types of compensation will apply, or if the nanny is sick, by what hour must she call you? If you require your nanny to have a car to drive your children, this should be included in the contract, as well as listing expenses you will reimburse.

A confidentiality clause should be included. The nanny's close relationship will make her privy to household information that you may prefer to remain private. This can include information about family health, finances, career or relationships.

The contract should detail emergency contact information, including the contact information for the children's doctor and dentist, insurance information and hospital preference. An emergency plan in the contract should state which parent is the primary contact when the nanny is on duty and the steps the nanny should take in the event of an emergency.

Termination is an inevitable consideration in any employment relationship. Define termination notice on both sides. You may want to request four weeks notice from the nanny and either offer four weeks notice to the nanny or compensation in lieu of the four weeks notice, unless the nanny is terminated for cause. If the nanny is terminated for good cause, she should be given zero notice.

Finally, be sure to state clearly and unequivocally that the nanny's employment is terminable at will, that you may terminate her at any time, with or without cause, and that the contract does not assure her of employment in any way.

### **What Are the Tax Consequences of Hiring a Nanny?**

Must you withhold taxes or pay payroll taxes? You need to determine if you have a household employee. If you hire a nanny to work in your home, the nanny is a household employee. If the nanny performs child care services at her own home, then she is not your household employee for tax purposes.

If you have a household employee, you may need to withhold taxes and pay the social security and Medicare taxes and unemployment taxes. There are some exceptions that may apply. One is if the nanny is under the age of 18 at any time during the year and being a nanny is not her principal occupation. Otherwise you must withhold the employee's share of social security and Medicare taxes if you expect to pay your nanny wages of \$1,500 or more in 2007, or you may pay the taxes yourself.

If you pay the nanny to care for your child under the age of 13 so that you (and your spouse if you are married) may work or look for work, you may be able to claim an income tax credit.

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*A: Fiction.* Although this trite scene is a continuing mainstay of some of the worst courtroom television programs ever written [think of *Perry Mason* and *Matlock*], this scene is pure fiction. Every *Perry Mason* episode and most *Matlock* episodes end with this nonsense, but in the real world this absolutely never happens.

*Defense attorneys in criminal cases never solve the crime and never extract an in-court confession from anyone. Indeed, they don't even try to do so. Instead, they defend the accused by trying to chip away incrementally at the evidence presented by the prosecution, to try to create a doubt as to whether the State proved the defendant guilty beyond a reasonable doubt, as the State is required to do.*

*In a real courtroom, if witness A were actually to confess in open court to the crime for which defendant B is on trial, no prosecutor would ever ask the judge to dismiss the case against defendant B. The prosecutor's first instinct would be that A and B probably cooked up this little act between them, and that defendant B, not witness A, did exactly what defendant B is accused of doing.*

*Just to be safe, the prosecutor would probably try both A and B for the same crime. The one thing you can be sure the prosecutor would never do is voluntarily let B walk – except, of course, if B's defense attorney is *Perry Mason* or *Ben Matlock*.*

## RECENT ANNOUNCEMENTS

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ACHIEVEMENTS OF NOTE

**Michael Schlesinger**, a member of the adjunct faculty of the John Marshall Law School, helped prepare the school's negotiation team for the international negotiation competition held in Singapore in July. The team finished sixth in the world.

**Andrés Gallegos** co-chaired a program and presented a paper on the emergence of retail health clinics, at the American Bar Association's convention in San Francisco. Andres also lectured at the Southern Illinois University School of Medicine on physician employment legal issues.

**Alan Wolf** has been appointed as General Counsel of *Amigos de las Americas*, an international, not-for-profit, privately funded, voluntary organization that provides youth leadership development opportunities, promotes community health for the people of Latin America and facilitates cross-cultural understanding for the people of the Americas.

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