

TITLE ISSUES

BUILDING CODE VIOLATIONS: THE RISK THAT CANNOT BE IGNORED

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INTRODUCTION

In a previous edition, *Title Issues* explored the relationship between title insurance coverage and zoning regulations. In this article, *Title Issues* will examine another aspect of the exercise of the police power by local governments,¹ namely the enforcement of building codes. This examination is appropriate because recent legislation has, with respect to unsafe buildings, granted to counties the same powers, lien rights, and enforcement procedures that have long been available to municipalities.² This article will consider the impact of county or municipal enforcement of building code provisions on (1) the documentation of a real estate transaction, (2) the status of title during an enforcement proceeding, and (3) the potential for landowners and lienholders to lose their interests in the property at the conclusion of an enforcement proceeding.

BUILDING CODES: AN EXERCISE OF LOCAL GOVERNMENT POLICE POWERS

The police power is a pervasive and coercive tool used by a local government to regulate conduct within the community. The police power may be defined as the exercise of governmental power to limit, regulate, or prohibit personal and business activity and property uses without government compensation in order to protect the public health, safety, morals, and welfare. In Illinois, the state's Constitution and statutes confer on local governments the authority to exercise police powers,³ including, among many other things, the power to enact housing and building codes. Counties, for example, may regulate the construction, alteration, and maintenance of buildings in order to make them reasonably safe from various hazards.⁴ Similarly, municipalities may prescribe the strength and manner of constructing all buildings.⁵ The Constitution and

statutes also enable local governments to restrain or abate violations of their building codes.⁶ Therefore, all local government building codes must contain provisions for (1) investigation and supervision to assure compliance or to initiate enforcement proceedings, (2) enforcement proceedings to bring properties into compliance, and (3) penalties in the event landowners fail to comply with enforcement orders. Penalties may include fines on the landowner or even forced demolition of a non-complying building. The most severe penalty for non-compliance authorized by state law, however, permits a local government to acquire title to the property and to terminate landowner and lienholder interests in the property without compensation.

REAL ESTATE TRANSACTIONS: KNOWLEDGE OF CODE VIOLATIONS IS CRUCIAL

Because building code violations can lead to substantial penalties, including costs of repairs, fines for non-compliance, or loss of improvements or even title to the land, prospective purchasers and lenders of improved properties must learn as much as possible about potential problems prior to closing. In this regard, however, title insurance may not offer significant assistance. Commitments for title insurance and policies issued pursuant to those commitments will only reveal building code violations under very limited circumstances. The American Land Title Association (ALTA) owner and loan policies contain the following exclusion from coverage:⁷

The following matters are expressly excluded from the coverage of this policy and the Company will not pay loss or damage, costs, attorney's fees or expenses which arise by reason of:

1. (a) Any law, ordinance or governmental regulation (including but not limited to

building and zoning laws, ordinances, or regulations) restricting, regulating, prohibiting or relating to (i) the occupancy, use or enjoyment of the land; (ii) the character, dimensions or location of any improvement now or hereafter erected on the land; . . . , or the effect of any violation of these laws, ordinances or governmental regulations, except to the extent that a notice of the enforcement thereof or a notice of a defect, lien or encumbrance resulting from a violation or alleged violation affecting the land has been recorded in the public records at Date of Policy.

The ALTA policies define public records as “records established under state statutes at Date of Policy for the purpose of imparting constructive notice of matters relating to real property to purchasers for value and without knowledge.”⁸ The ALTA policy provisions are based on the conclusion that title insurers lack time, resources, and expertise to search for notice of building code violations in inspector reports and notations on administrative hearing dockets in building departments. Thus, title commitments will not disclose a substantial number of building code violations to prospective purchasers and lenders, and title companies will not be liable to their insureds for failing to show building code violations unless notice of such violations has been recorded in the Office of the Recorder of Deeds. Yet, in the Chicago metropolitan area, many title insurers, including Chicago Title Insurance Company, will raise title exceptions on a commitment when there is a pending enforcement proceeding in building court — regardless of whether the plaintiff local government has recorded a *lis pendens* notice. Under the terms of the policy, however, there is no liability for failing to show a proceedings pending without a recorded *lis pendens* notice.

DOCUMENTING A REAL ESTATE TRANSACTION

Attorneys for purchasers and lenders must, therefore, seek more information about building code violations than title insurers provide. Contracts of sale and loan agreements should contain provisions for disclosure and inspection. For example, buyer’s counsel may require that a contract of sale include a provision requiring seller to inform buyer if there is a known existing violation, officially noticed or otherwise.⁹ If seller cannot make a warranty on this matter, then seller should provide buyer a detailed statement of all violations referred to in any notices received by or known to seller. It may also be appropriate to include the requirement of repairing any building code violations in a “condition of premises” or “repairs” section

of the contract. Purchasers may also wish to conduct an inspection of the property not only before the contract is executed but also shortly before closing.

To illustrate, the Real Estate Sales Contract printed and distributed by Chicago Title Insurance Company and used for sales of multi-dwelling structures, commercial properties, and industrial properties, contains the following provision:¹⁰

8. Seller warrants that Seller, its beneficiaries or agents of Seller or of its beneficiaries have received no notices from any city, village or other governmental authority of zoning, building, fire or health code violations in respect to the real estate that have not been heretofore corrected.

In contrast, the Real Estate Sales Contract published and distributed by Chicago Title Insurance Company and used for residential properties contains no such provision. The residential contract does, however, allude to the Residential Real Property Disclosure Act.¹¹ The disclosure form prescribed by the Act compels the seller to state whether he or she is aware of material defects or unsafe conditions on the property. Specifically, the disclosure form requires the seller to respond YES, NO, or NOT APPLICABLE to the following statement:¹²

22. I have received notice of violation of local, state, or federal laws or regulations relating to this property, which violation has not been corrected.

The Act reminds the buyer that the responses on the disclosure form are only based on the actual notice or actual knowledge of the seller without requirement of any specific investigation.¹³ Thus, buyer’s counsel must carefully consider the sufficiency of the above-noted provisions and assess the need for additional contract terms.

PROCEEDINGS PENDING

Routine building code violations will generally be handled in a routine manner.¹⁴ In some municipalities, building code violations may be handled through an administrative hearing process.¹⁵ An inspector will file a report of violation, and the property owner, tenant, or property manager will be summoned to an administrative hearing. If the hearing officer is satisfied that a violation exists, the respondent will be ordered to make appropriate repairs. Once repairs are completed and verified by a re-inspection, the hearing officer will dismiss the proceeding. Should the respondent fail to appear or to make the appropriate repairs, however, the hearing officer may impose a fine against the respondent. Notice of administrative hearings will not

appear in the public records, and title companies will make no reference to them unless the municipality records a notice of a fine or other disposition.

More frequently, local governments enforce building code violations by summoning the owner, tenant, or property manager to building court. Respondents in building court will also be expected to make repairs or face fines. If the court is satisfied that a violation exists, the court will order the respondent to make appropriate repairs. Once repairs are completed and verified by a re-inspection and court costs paid, the court will dismiss the case. Should the respondent fail to appear or fail to make appropriate repairs, however, the court may impose a fine against the respondent. Generally, cases will not be dismissed until all costs and fines are paid or vacated.

For serious violations, however, local governments have serious remedies. When buildings become dangerous and unsafe, from neglect, abandonment, failure to complete construction, or otherwise, local governments may take the following actions or cause the following actions to be taken: demolish, repair, or enclose any dangerous and unsafe building or remove garbage, debris, and other hazardous, noxious, or unhealthy substances or materials from those buildings.¹⁶ The local government must send a mailed 15-day notice to all owners of the land and to all lienholders of record demanding that dangerous and unsafe conditions be corrected. In the absence of a response, the local government may request the circuit court to grant authority to take any of the actions noted above. If the court approves corrective measures, such as demolishing the unsafe building, then the costs incurred by the local government in carrying out the court order, together with court costs and attorneys fees, shall constitute a lien on the land. For convenience, the lien will hereinafter be referred to as a “demolition lien”, regardless of the type of corrective action taken by the local government. The demolition lien is superior to all prior existing liens and encumbrances, except real estate taxes and special assessments, if, within 180 days of completing the demolition work, the local government records a notice of lien at the office of the county recorder. There is no limitation period within which the demolition lien must be enforced. Thus, the local government may commence an enforcement proceeding at any time after recording a demolition lien.¹⁷

STATUS OF TITLE DURING AN ENFORCEMENT PROCEEDING

Most title insurers in the Chicago metropolitan area, including Chicago Title Insurance Company, will raise title exceptions for any building code

proceedings pending in the circuit court, whether for routine or for serious matters, even if the local government fails to record a *lis pendens* notice. While the structures on the land still stand, these exceptions will not be waived unless the case is dismissed. Occasionally, a municipality may agree to subordinate the pending proceeding to the lien of a new construction mortgagee whose loan proceeds will pay for the cost of bringing the building into code compliance. Since this subordination maneuver may be desirable to a construction lender, its meaning should be clear. With a well-drafted subordination agreement, if the municipality obtains a demolition lien through the subordinated proceeding and later forecloses the demolition lien, the municipality will take title to the land subject to the mortgagee’s interest — whether the mortgagee has foreclosed its mortgage or not. If this is what the lender wants and is what the municipality acknowledges, then the subordination agreement should set out these understandings in clear language. Otherwise, the title insurer will issue the loan policy subject to the pending proceeding. Owners policies will always issue subject to a pending building code case notwithstanding any subordination arrangement between lender and municipality.

If the improvements on the land have been demolished and a demolition lien appears of record, the title insurer will raise additional exceptions for recorded demolition liens and for any demolition lien foreclosure proceedings. Owners and loan policies may only issue free and clear of lien and proceedings exceptions when the demolition liens have been released of record and when all pending proceedings have been dismissed. To release and dismiss, the local government will generally insist upon full reimbursement for all demolition costs, court costs, and attorneys fees.¹⁸

THE FINAL FRONTIERS OF POLICE POWER: FORECLOSURES AND FORFEITURES LEAD TO LOSS OF PROPERTY INTERESTS

In the ultimate exercise of police powers, local governments are authorized to acquire title to property without compensation to landowners or lienholders. Through demolition lien foreclosure proceedings, local governments may acquire title to vacant land on which the local government demolished unsafe buildings. Through forfeiture-like proceedings, local governments may acquire title to land that currently contains abandoned buildings. In either case, landowners and lienholders will lose their interests in the land without compensation.

A local government may proceed to foreclose a demolition lien in the original, undismissed, building court

case.¹⁹ The foreclosing plaintiff must petition the court to retain jurisdiction for foreclosure purposes. Notice of this petition must be served by certified or registered mail on all owners and lien holders of record. If the court agrees to retain jurisdiction, then all necessary parties, as defined in the Illinois Mortgage Foreclosure Law²⁰ (IMFL) must be joined, and persons defined as permissible parties may also be joined as parties in the action. Thereafter, the court will consider a petition for foreclosure and sale. The provisions of IMFL will apply to the foreclosure proceeding, except that the redemption period from an order for foreclosure and sale will end 60 days after the date the order was entered.²¹ If the court enters an order of foreclosure and sale, and no redemption occurs, then the property will be sold to satisfy the demolition lien. The successful bidder will take title to the land free and clear of the interests of all persons who were parties to the proceeding.

As an alternative, the local government may seek to foreclose a demolition lien in a new proceeding.²² This type of foreclosure may proceed under IMFL or in the manner of foreclosure of mechanics lien claims. Once again, necessary and permissible parties must be before the court in order to assure that their interests will not survive a foreclosure sale.

In most foreclosure cases, the foreclosing plaintiff is the only bidder at the sale. In some instances, however, third parties may outbid the plaintiff. In either event, the grantee of a deed derived through the foreclosure sale may request a title insurer to review the proceeding. If the title insurer is satisfied that owners and lienholders have all been served with notice of the foreclosure proceeding and that foreclosure requirements have all been fulfilled, then the title insurer will issue an owner's title insurance policy insuring the successful bidder's title to the land. The former interests of title holders and lienholders will be deleted from the policy. The policy will, however, be subject to easements, covenants and restrictions running with the land, certain federal interests in the land, and real estate tax liens.²³

ABANDONED BUILDINGS

With respect to abandoned buildings, local governments have yet another means of acquiring title free and clear of the rights of owners and lienholders. Local governments may utilize a two-step process that resembles a forfeiture proceeding.²⁴ In the first step, the local government may file a new case and petition the circuit court for a declaration

that the property has been abandoned. Property will be declared abandoned if:

- (1) the property has been tax delinquent for 2 or more years or bills for water service for the property have been outstanding for 2 or more years;
- (2) the property is unoccupied by persons legally in possession; and
- (3) the property contains a dangerous or unsafe building.

In connection with the petition, the local government must name as defendants and serve with process all persons having an interest of record in the land, as well as beneficiaries of a title-holding land trust. The local government must also publish notice as in other cases under the Code of Civil Procedure,²⁵ although no provision is specifically made for publication against unknown owners. Similarly, there is no provision for recording a lis pendens notice, but Chicago Title has suggested that local governments record a lis pendens notice when utilizing this procedure.

If all defendants fail to appear and the local government proves that the property is abandoned, then the court shall declare the property abandoned. Thereafter, the second step begins. The local government must next send by certified or registered mail notice to all defendants that title to the land will be transferred to the local government unless, within 30 days, either (1) the owner appears in the proceeding or (2) some other defendant appears and volunteers to demolish or repair the unsafe building. If no one steps forward at this stage, the local government may petition the court to issue a judicial deed conveying the land to the local government. A conveyance by judicial deed shall operate to extinguish all existing ownership interests in, liens on, and other interests in the property. Title insurers will insure the title of the local government or its grantee free and clear of those former interests in the land.²⁶

As an alternative, the local government may seek an order of abandonment and an order for the issuance of a judicial deed in the original, undismissed, building court case.²⁷ In this proceeding, the local government must serve notice by certified or registered mail on all persons who were served notice in the original action. Chicago Title has recommended, however, that service of process should be attempted as in the proceeding described above.

The City of Chicago has organized a program known as the Chicago Abandoned Property Program (CAPP) to systematically obtain titles

through orders of abandonment and judicial deeds. The CAPP initiative is designed to improve the condition of housing stock within the City by enabling the City to acquire title to properties with unsafe buildings and to transfer title to persons who commit to rehabilitating the buildings. Since CAPP's inception, the City of Chicago has acquired numerous parcels, and Chicago Title has insured the City, its grantees, and construction lenders. CAPP has become a valuable tool in the City's efforts to increase the supply of affordable housing. With similar powers now granted to counties, it is anticipated that more CAPP-like efforts will occur in the Chicago metropolitan area.

CONCLUSION

Building code enforcement procedures play an important role during the acquisition and ownership of real property. At the acquisition stage, buyers and lenders should obtain as much information as possible about the condition of buildings on the land, about prior code violations, and about present code violations, if any. If a local government initiates code enforcement proceedings against the land, owners have the obligation to appear at such proceedings and to repair confirmed code violations. Failure to appear or to make repairs may subject the owner to fines or to loss of the structures on the land. Failure to reimburse the local government for costs it incurred in repairing or demolishing the structures may, ultimately, subject the owner to loss of title through foreclosure. Lenders must consider these same risks in the event of owner default. In proceedings for an order of abandonment, owners and lenders alike have little choice. They must commit to demolishing an unsafe building or to bringing it into code compliance — or else lose title to the property through judicial deed. In either event, whether through foreclosure or through forfeiture, landowners and lienholders will lose their interests in the land without compensation.

¹ For the purposes of this article, the term "local government" shall mean counties and municipalities.

² See P.A. 89-585, effective January 1, 1997, creating a new section of the Counties Code to be codified as 55 ILCS 5/5-1121, and containing provisions that closely parallel portions of the Municipal Code, such as 65 ILCS 5/11-31-1.

³ Consider, e.g., the extensive list of powers granted to counties in Article 5 of the Counties Code, 55 ILCS 5/5-1001 et seq. and the even more extensive list of powers granted to municipalities in Article 11 of the Municipal Code, 65 ILCS 5/11-1-1 et seq. See also Article 7, Section 6 of the Illinois Constitution of 1970 which states that, subject to certain exceptions, any home rule county and municipality "may exercise any power and perform any function pertaining to its government and affairs including, but not limited to, the power to regulate for the protection of the public health, safety, morals, and welfare." Compare police power to the eminent domain power in which a government taking of private property for a public purpose must include just compensation to the owners.

⁴ 55 ILCS 5/5-1063.

⁵ Consider, 65 ILCS 5/11-30-4.

⁶ Consider, 55 ILCS 5/5-1063, 5-1080, and new 5-1121 (counties); 65 ILCS 5/11-31-1 (municipalities).

⁷ Paragraph 1 (a) of the Exclusions from Coverage, 1992 Form ALTA Owner and Loan policies.

⁸ Paragraph 1 (f) of the Conditions and Stipulations, 1992 Form ALTA Owner and Loan policies.

⁹ See the Dwelling Unit Installment Contract Act, 765 ILCS 75/1 et seq. regarding certifications and written statements about code violations and notices thereof to be attached to articles of agreement for deed.

¹⁰ Chicago Title Insurance Company, Real Estate Sales Contract, Form B, revised July 1996.

¹¹ 765 ILCS 77/1 et seq.

¹² 765 ILCS 77/35. The author fails to understand how the NOT APPLICABLE response is appropriate to most of the questions and statements on the disclosure form.

¹³ Id. Note that neither form contract nor the disclosure form consider noticed building code violations that *were repaired*.

¹⁴ Due to space limitations, enforcement procedures can only be outlined in the briefest manner in this article. For detailed information, practitioners should consult local government codes and enforcement officials.

¹⁵ The City of Chicago has established administrative hearing procedures for reported violations of various municipal codes. For instance, violations of the Building Code and violations of the Streets and Sanitation Code may be disposed of by hearing officers within the Building Department and the Department of Streets and Sanitation.

¹⁶ See generally new 55 ILCS 5/5-1121 (counties) and 65 ILCS 5/11-31-1 (municipalities). These statutes contain the procedures outlined in the remainder of this article. There is very little difference between the two statutes. Thus, all statements in the text refer to both counties and to municipalities.

¹⁷ Municipal Code formerly contained a provision that required municipalities to commence foreclosure proceedings within three years after recording the demolition lien. The limitation period was removed by P.A. 86-680, effective September 1, 1989. Similarly, the Counties Code contains no limitation period. Hence, a demolition lien may be foreclosed at any time after recordation.

¹⁸ If a title insurer seems reluctant to waive "old" building code cases, consider how, in the next section of text "old" cases may be turned to "new" purposes.

¹⁹ New 55 ILCS 5/5-1121 (b) (counties); 65 ILCS 5/11-31-1 (b) (municipalities).

²⁰ 735 ILCS 5/15-1501.

²¹ Compare 735 ILCS 5/15-1603, which contains longer redemption periods in mortgage foreclosure proceedings.

²² New 55 ILCS 5/5-1121 (a) counties; 65 ILCS 5/11-31-1 (a) (municipalities). Unlike the proceedings brought under the provisions cited in footnote 19, the "normal" redemption periods in mortgage and mechanics lien foreclosure proceedings apply.

²³ Except for real estate tax sales, however, municipalities acquiring title through demolition lien foreclosure may arrange for county officials to mark delinquent taxes null and void. See 35 ILCS 200/21-95 et seq. ("all due or unpaid property taxes and existing liens for unpaid property taxes...shall become null and void.") This provision was intended to apply to counties as well, but its language fails to accomplish that goal. This problem was not remedied in P.A. 89-585. Thus, counties acquiring title through foreclosure of demolition liens may not be able to arrange for taxes to be marked null and void.

²⁴ New 55 ILCS 5/5-1121 (c) counties; 65 ILCS 5/11-31-1 (d) (municipalities).

²⁵ 735 ILCS 5/2-206.

²⁶ See text accompanying footnote 23. The provisions of 35 ILCS 200/21-95 et seq. also apply when municipalities acquire title through judicial deeds. Counties, however, may be precluded from utilizing these provisions. See footnote 23.

²⁷ New 55 ILCS 5/5-1121 (c) (counties); 65 ILCS 5/11-31-1 (d) (municipalities).