

# TITLE ISSUES

## *INSURING A CONDOMINIUM DECLARATION: AN OVERVIEW*

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The practitioner preparing a condominium declaration must look ahead to the goal — sale of individual units — from the outset. To assist the practitioner in achieving the goal, Chicago Title Insurance Company can review a draft declaration with the drafter. The title insurer's objective in this review will be to confirm that a legal basis exists for, ultimately, insuring title to each condominium unit and for insuring the priority and enforceability of a mortgage lien on each unit. Some considerations for insuring title to a condominium unit are discussed below.

### **I. Statutory Basis for Condominium Draftsmanship**

The Condominium Property Act<sup>1</sup> mandates a recorded declaration expressly submitting property to the Act<sup>2</sup> and then sets forth at Section 4<sup>3</sup> the minimum required contents of a declaration submitting property to the condominium form of ownership. Any declaration must include:

“(a) The legal description of the parcel.” The estate submitted to the Act is a fee parcel and the legal description should include land and improvements, if any. It can also include easement rights benefiting the parcel. These rights may then be extended to unit owners, subject to any limitations resulting from possible overburdening of the easement. With one specialized exception,<sup>4</sup> a leasehold estate may not be submitted to condominium status.

“(b) The legal description of each unit.” The declaration creates a legal description for each unit by unit name or number, referring to the plat of survey recorded with the declaration and the list of unit names attached to the declaration. The resulting unit legal description will read as follows:

“Unit X in Y Condominium as delineated on a survey of the following described real estate: Lots A and B in Subdivision C in Section 1, Township 2 North, Range 3, East of the Third Principal Meridian, Cook County, Illinois; which survey is attached as Exhibit “A” to the Declaration of Condominium recorded as

Document No. 96000000 together with its undivided percentage interest in the common elements.”

The survey depicts the location and dimensions of each unit and the list states the exact percentage interest in the common elements assigned to each unit.

“(c) The name of the condominium, which name shall include the word ‘condominium’ or be followed by the words ‘a condominium.’”

“(d) The name of the city and county or counties in which the condominium is located.”

“(e) The percentage of ownership interest in the common elements allocated to each unit. Such percentages shall be computed by taking as a basis the value of each unit in relation to the value of the property as a whole, and having once been determined and set forth as herein provided, such percentages shall remain constant unless otherwise provided in this Act or by agreement of all unit owners.” Relative value ordinarily is based on selling price of the units; however, this may be questioned in some situations, such as a condominium composed of both residential and commercial units.<sup>5</sup> Since the percentage interest must be the basis for condominium assessments for common expenses, owners of residential units may wish to see owners of commercial units pay a greater share of the common expenses because a commercial unit may consume a disproportionate share of the common benefits, e.g., electric service. Further, no provision can be made for different classes of units.<sup>6</sup>

“(f) If applicable, all matters required by this Act in connection with an add-on condominium.” Section 25<sup>7</sup> provides a scheme for a developer to identify in the declaration additional land for future development, reserve the right against future unit owners and mortgagees to add such property to that already submitted, and reallocate percentage ownership interests in the common elements.<sup>8</sup> The developer must acknowledge the obligation to complete the add-on process within a stated period not to exceed ten years.<sup>9</sup> In addition, the developer must

provide information including the maximum number of units, the proposed location of improvements, and the intended plan for adding property, e.g., size limitations on phases or the order in which the phases are to be added. The developer is not thereby bound to complete the add-on nor to proceed exactly as outlined in the declaration. Instead, these provisions establish a foundation the developer may use to amend the declaration unilaterally from time to time, recording simultaneously a revised plat portraying the added units. The ability to form large condominium developments by successive add-on amendments gives the developer flexibility to carry out a large scheme over time. This flexibility also includes the ability to abandon or modify a plan in light of unforeseen or changing market factors.

“(g) A description of both the common elements and the limited common elements, if any, indicating the manner of their assignment to a unit or units.” The statutory definition of common elements, “all portions of the property except the units, including limited common elements unless otherwise specified”,<sup>10</sup> can be set out in the declaration. Limited common elements, a portion of the common elements intended for the exclusive use of a unit or units,<sup>11</sup> typically include service pipes and lines, balconies, storage spaces, and parking spaces. The designation of limited common elements is a unique and crucial feature of each condominium development and the declaration should be drafted with care on this matter. Of the items listed above, parking is the most sensitive matter to condominium unit owners and prospective unit owners. Since parking can be a contentious issue it is particularly important to create the legal right according to any one of the following methods.

There are three ways to assign a parking limited common element to a unit: First, the schedule of units with their respective percentage interests can list the parking spaces appurtenant to each unit. Second, the developer’s deed to the initial buyer of the unit can contain language granting to the unit owner the exclusive right to use the parking space. Third, the survey itself can be the means of assigning the parking space to the unit by indicating, for example, “P-3, L.C.E. to Unit 15” on the face of the plat. In each case the plat recorded with the declaration must delineate the boundaries of the parking space and label the space with its identifying number or name.

In addition to establishing parking rights as limited common elements, rights to a particular parking space can be established by creating separate individual units, each with its percentage ownership interest and separate tax bill. Like any other unit, these parking spaces are conveyed by deed. Or, a parking space can be part of a unit, for example, in a townhouse structure in which the ownership is in the condominium form and the parking area is the lower part of the unit or is included in the legal description of the unit.

Under any of the above methods a title insurer will insure

the exclusive right to a particular parking space as a Parcel 2 in the legal description. In some condominiums exclusive legal rights to a parking space have not been established by the above described methods. The condominium association regulates the parking lot as part of its function to administer the use of the common elements.<sup>12</sup> The association can assign spaces, charge fees, or even write leases to spaces. However, title insurers decline to insure the unit owners’ contract rights in the absence of a recorded deed or grant.

“(h) If applicable, all matters required by this Act in connection with a conversion condominium.” When an existing apartment building is converted to condominium ownership, the law provides certain safeguards for the tenants. Section 30<sup>13</sup> requires a notice from the developer to each tenant at least 30 days before recording the declaration which must include a list of selling prices for all units and an offer to sell the tenant’s apartment to the tenant. A certificate must be attached to the recorded declaration that the notice has been timely given.

The Act establishes other rights of tenants, including the right to extend their tenancy for a minimum of 120 days from the date of the notice and a right of first refusal against a third-party offer to purchase the unit occupied by the tenant. If the tenant expressly waives or does not properly and timely exercise the right of first refusal or the option to purchase, or if the tenant did not qualify under the Act to such rights, a statement to that effect on the developer’s deed to a third-party purchaser enables the purchaser to take the unit free and clear of the tenant’s statutory rights.<sup>14</sup>

One unexpected effect of the tenant-rights legislation occurs in the conversion of a cooperative apartment building to condominium. As holders of shares in the ownership of the building, the cooperative apartment owners have a legal right to tenancy of their specific apartment by virtue of proprietary leases. If a coop owner sublets his or her apartment, that subtenant would benefit from the tenant’s rights outlined above, a result sometimes unanticipated by the owner or drafter of a coop-to-condo conversion. Otherwise a coop conversion contains no special problems, except some title cleanup including abrogation of the cooperative agreement or charter and termination of the proprietary leases in exchange for deeds to the newly-formed units.

“(i) Such other lawful provisions not inconsistent with the provisions of this Act ... to promote and preserve the cooperative aspect of ownership of the property and to facilitate the proper administration thereof.” This catch-all paragraph typically invites a voluminous declaration laying out the ground rules for communal living and covering such topics as insurance reserves, powers and duties of the board, amendments to the declaration, to name a few. At Section 18<sup>15</sup> the required contents of the bylaws are set forth, with rules for meetings, notices, assessment increases, board elections, and the like; many

of these statutory provisions are applicable to all condominiums whether or not they are contained in the declaration.<sup>16</sup>

Section 5 of the Act<sup>17</sup> describes the requirements for the survey to be recorded with the declaration. In addition to platting the parcel and the improvements as a whole, the plat must set forth the boundaries, elevations, and dimensions of each unit, and must identify each unit by a distinguishing number or symbol. In the event that a unit has not been completely constructed at the time the declaration is recorded, an amended plat showing the unit as built must be recorded before it can be conveyed to a buyer.

## **II. Title Insurance Considerations Affecting Condominium Draftsmanship**

In examining a proposed condominium declaration for the purpose of insuring unit sales, a title insurer's attention focuses on a few topics dear to the heart of the underwriter: easements, liens, options, rights of first refusal, to name the most prominent. After determining that the declaration is to be executed by the proper parties with record title and by all mortgagees and that the matters outlined above have been complied with, the examiner turns to the following:

### **Easements**

The usual source of easements benefiting or burdening a condominium parcel is an umbrella or master declaration, i.e., a declaration of covenants, conditions, restrictions, and easements regulating rights and obligations of a number of separate condominiums or other properties in an organized complex. The condominiums might be geographically situated as "islands" in a common area, title to which is held by a community association. The master declaration will grant easements to all unit owners for ingress and egress, recreation, or other purposes, sometimes including parking. To insure an easement, the underwriter looks for record title to the servient parcel in the declarant, joinder by any parties with record interests (generally mortgagees, but including any lessees or others), and a split in title between holders of the servient parcel and the condominium, or dominant, parcel. When the master declaration is recorded while title to the entire complex is still in one party, a formal grant and reservation of easements, referencing the master declaration, must be made at the time title to any part of the complex is conveyed to a different trust or declarant, or even at the time a unit is conveyed to a purchaser. Words of grant and reservation should be used in the deed, or a separate grant can be recorded.

### **Options and Rights of First Refusal**

For the initial sales in a condominium development, any tenants' rights, as outlined above, must be dealt with. Additional problems may affect resales. Some declarations contain a right of first refusal in favor of the associ-

ation on resale of units or, rarely, an option to purchase in favor of other unit owners or the association. The latter is found occasionally in connection with a parking unit. At the time of resale of a unit, a current letter waiving any applicable right of first refusal or option must be obtained from the association and any other interested party. This requirement will be noted on the title commitment.

### **Assessment Liens**

The Act creates a lien in favor of the condominium association for the nonpayment of assessments that arises when assessments become delinquent. A lender expecting to hold a mortgage on a condominium unit must be assured of priority over liens for common expense assessments. A pre-existing delinquency in assessment payments creates a lien to threaten that priority.<sup>18</sup> Therefore the declaration must provide a vehicle for subordinating the assessment lien to a mortgage; prior to closing on the mortgage, a letter must be obtained from the association stating that assessments are paid through a date covering the closing date. Further, the lender wants assurance from the title insurer that the mortgagee will take title, if necessary, through foreclosure proceedings free and clear of liens for unpaid assessments that arose prior to or during the period of foreclosure. The Act,<sup>19</sup> as well as many declarations, gives this comfort to the lender. A lender's interest is only subject to the lien of assessments that arise after the lender obtains a court order approving foreclosure sale, accepts a deed in lieu of foreclosure, obtains a consent judgment vesting title in the lender, or obtains possession pursuant to court order.

A similar analysis applies to the lien of assessments under a master declaration. The lender looks for priority and the master declaration should contain language limiting the priority of the lien of master association assessments to encumbrances recorded after a delinquency in payment of assessments; also, the declaration should provide that the foreclosing lender's duty to pay assessments commences at the time of a sheriff's deed, consent foreclosure order, deed in lieu of foreclosure or possession by the lender.

## **III. Title Insurance Coverage**

The form of title insurance coverage available to a condominium unit buyer or lender consists of the policy itself, showing the insured legal description in Schedule A as "Unit X in the Y Condominium . . ." This usage insures that the condominium legal description is a valid description of the property being conveyed or mortgaged and that a mortgage shown as insured in Schedule A is a valid and enforceable lien on the unit itself. Lenders generally ask for more specific and detailed coverage in the form of the American Land Title Association Endorsement No. 4.<sup>20</sup> The endorsement expressly insures that the condominium declaration complies sufficiently with the Act; that its existence and identity as a condominium would be upheld by a court; that the units are being put to uses permitted under the condominium declaration; that any insured

mortgage has priority over condominium assessment liens; that the unit is entitled to a separate tax bill; that no unit encroaches on another or on the common elements; and that no enforceable right of first refusal exists with respect to an insured unit. The endorsement is based generally on compliance of the declaration with the Act and, in particular (as to priority), on the assessment letter from the condominium association and waiver of any right of first refusal.

### **Parking**

The transfer of a parking space, apart from the sale of a unit, is often insured. If the parking space is a condominium unit with percentage interest, condominium assessment bill, and tax bill of its own, it may be transferred by deed, subject to any restrictions in the declaration as to eligible grantees. (For example, a provision may limit ownership of parking units to owners of residential units.) The title insurance vehicle is a separate policy for the transferred unit or an amendment to the owner's existing policy that guarantees title to his or her residential unit. The parking unit may be included as an additional insured fee parcel. Ordinary clearance for the sale of a unit is required by the insurer; a mortgage lien on the unit must not be overlooked.

If the parking space is a limited common element, appurtenant to a unit, it can be transferred to another unit owner by following the statutory scheme at Section 26.<sup>21</sup> The transfer is accomplished not by a quit claim deed, but by a mini-amendment to the condominium declaration that detaches the exclusive right to use the parking space from one unit and attaches it to another unit. The amendment is executed by all unit owners who are parties to the transfer and consented to by any unit owners who have a right to use the limited common element. Again, the mortgagee of the unit that is losing its parking space must join in execution of the amendment since the mortgage lien includes the limited common element. The amendment must certify that notice has been delivered to the board of managers and must reflect

any adjustment in the units' respective percentage interests.

The title insurer that issued the owner's policy to the unit that is gaining the parking space can issue an endorsement dating down the owner's policy and adding a parcel as the "exclusive right to the use of parking space P, a limited common element appurtenant to Unit X in Y Condominium. . ." Ordinary clearance is required, i.e., ALTA statements from both unit owners and an assessment letter with waiver of the right of first refusal (if any) for both units.

### **New Construction**

When a condominium is created on property with a newly-constructed building, there will be a question of possible mechanics' lien rights as to the underlying property. This can be underwritten by the usual procedure of submitting sworn owner's statements, general contractors' sworn statements, lien waivers from the general contractor and all parties disclosed by the general contractor, and by subcontractors' affidavits. Often a personal undertaking indemnifying the title insurer over mechanics' lien claims is accepted from a solvent developer when units are being sold before completion of the entire project.

A conversion condominium typically involves some degree of rehabilitation or cosmetic work on the building. The same possible lien situation exists as with a newly-built building. Based on the same kind of clearance, extended coverage can be given to unit owners and an ALTA loan policy can issue to the lender free of any exception for mechanics' lien claims.

While there are many matters connected with shepherding a condominium project to completion, the title insurer can provide guidance for creating a condominium on a firm legal basis. Insurable condominium unit titles will enhance the satisfaction of all parties to a condominium transaction, especially the mortgage lending community.

### **NOTES**

1. 765 ILCS 605/1 et seq. (1994), hereinafter referred to as the Act.
2. 765 ILCS 605/3 (1994).
3. 765 ILCS 605/4 (1994).
4. P.A. 89-0089, effective June 30, 1995, amending Sections 2, 3, 4, and 14.1 of the Act, which Sections are currently found at 765 ILCS 605/2, 765 ILCS 605/3, 765 ILCS 605/4, and 765 ILCS 605/14.1 (1994), respectively permitting a condominium to be established on a leasehold parcel where the fee owner is exempt from taxation under Section 501(c)(3) of the Internal Revenue Code of 1986 as amended.
5. 765 ILCS 605/9(a) (1994). This issue reflects one of several reasons that a "mixed" condominium, comprised of both residential and commercial units, or even one with high-rise and townhouse units, faces a rockier future than a condominium where the units are identical, or nearly so. Larger units may accommodate children, for example, and those unit owners might prefer a play lot in the common elements rather than

additional parking. Of course, there is no legal bar to a condominium providing for various uses to be made of the units.

6. 765 ILCS 605/18(b) (1994).
7. 765 ILCS 605/25 (1994).
8. 765 ILCS 605/25(b) (1994).
9. 765 ILCS 605/25(d) (1994).
10. 765 ILCS 605/2(e) (1994).
11. 765 ILCS 605/2(s) (1994).
12. 765 ILCS 605/18.4(a) (1994).
13. 765 ILCS 605/30(a) (1994).
14. 765 ILCS 605/30(a) (1994).
15. 765 ILCS 605/18 (1994).
16. 765 ILCS 605/18(p) (1994).
17. 765 ILCS 605/5 (1994).
18. 765 ILCS 605/9(g)(1) (1994).
19. 765 ILCS 605/9(g)(3) (1994).
20. A copy of ALTA Endorsement Form 4 is attached.
21. 765 ILCS 605/26 (1994).

OWNERS  LOAN

## ENDORSEMENT

ATTACHED TO AND FORMING A PART OF POLICY NUMBER SPECIMEN

ISSUED BY

CHICAGO TITLE INSURANCE COMPANY

### ALTA ENDORSEMENT FORM 4

THE COMPANY HEREBY INSURES AGAINST LOSS OR DAMAGE BY REASON OF:

1. THE FAILURE OF THE UNIT IDENTIFIED IN SCHEDULE A AND ITS COMMON ELEMENTS TO BE PART OF A CONDOMINIUM WITHIN THE MEANING OF THE CONDOMINIUM STATUTES OF THE JURISDICTION IN WHICH THE UNIT AND ITS COMMON ELEMENTS ARE LOCATED;
2. THE FAILURE OF THE DOCUMENTS REQUIRED BY SAID CONDOMINIUM STATUTES TO COMPLY WITH THE REQUIREMENTS OF THE STATUTES TO THE EXTENT THAT SUCH FAILURE AFFECTS THE TITLE TO THE UNIT AND ITS COMMON ELEMENTS;
3. PRESENT VIOLATIONS OF ANY RESTRICTIVE COVENANTS WHICH RESTRICT THE USE OF THE UNIT AND ITS COMMON ELEMENTS AND WHICH ARE CONTAINED IN THE CONDOMINIUM DOCUMENTS. SAID RESTRICTIVE COVENANTS DO NOT CONTAIN ANY PROVISION WHICH WILL CAUSE A FORFEITURE OR REVERSION OF TITLE;
4. THE PRIORITY OF ANY LIEN FOR CHARGES AND ASSESSMENTS PROVIDED FOR IN THE CONDOMINIUM STATUTES AND CONDOMINIUM DOCUMENTS OVER THE LIEN OF ANY INSURED MORTGAGE IDENTIFIED IN SCHEDULE A;
5. THE FAILURE OF THE UNIT AND ITS COMMON ELEMENTS TO BE ENTITLED BY LAW TO BE ASSESSED FOR REAL PROPERTY TAXES AS A SEPARATE PARCEL;
6. ANY OBLIGATION TO REMOVE ANY IMPROVEMENTS WHICH EXIST AT DATE OF POLICY BECAUSE OF ANY PRESENT ENCROACHMENTS OR BECAUSE OF ANY FUTURE UNINTENTIONAL ENCROACHMENT OF THE COMMON ELEMENTS UPON ANY UNIT OR OF ANY UNIT UPON THE COMMON ELEMENTS OR ANOTHER UNIT;
7. THE FAILURE OF TITLE BY REASON OF A RIGHT OF FIRST REFUSAL TO PURCHASE THE UNIT AND ITS COMMON ELEMENTS WHICH WAS EXERCISED OR COULD HAVE BEEN EXERCISED AT DATE OF POLICY.

THIS ENDORSEMENT IS MADE A PART OF THE POLICY AND IS SUBJECT TO ALL OF THE TERMS AND PROVISIONS THEREOF AND OF ANY PRIOR ENDORSEMENTS THERETO. EXCEPT TO THE EXTENT EXPRESSLY STATED, IT NEITHER MODIFIES ANY OF THE TERMS AND PROVISIONS OF THE POLICY AND ANY PRIOR ENDORSEMENTS, IF ANY, NOR DOES IT EXTEND THE EFFECTIVE DATE OF THE POLICY AND ANY PRIOR ENDORSEMENTS, NOR DOES IT INCREASE THE FACE AMOUNT THEREOF.

CHICAGO TITLE INSURANCE COMPANY

BY \_\_\_\_\_

AUTHORIZED SIGNATORY

**NOTE:** THIS ENDORSEMENT SHALL NOT BE VALID OR BINDING UNTIL COUNTERSIGNED BY AN AUTHORIZED SIGNATORY.