

# TITLE ISSUES

## *THE TWILIGHT ZONE: UNRAVELING THE MYSTERIES OF ZONING ENDORSEMENTS*

By: Allison F. Rabin, Esq.  
Agency Manager  
Chicago Title Insurance Company

The Twilight Zone. That's what many people think when dealing with title insurers and zoning endorsements. But, the twilight zone may become a comfort zone if handled properly by the legal practitioner whose clients request zoning coverage along with title insurance. This article will provide a brief overview of zoning ordinances and will describe the standard title policy jacket provisions, types of zoning coverage available and a title insurer's requirements for providing such zoning coverage. Further, this article will review the assurances found in zoning endorsements and will reveal those matters which are excluded from zoning endorsements.

### **I. Zoning Ordinances**

Land usage and development are typically governed by local zoning ordinances enacted by municipalities or counties. Zoning ordinances generally contain the following: (a) a zoning map, which divides the area into zoning districts, (b) general provisions that specify various restrictions and regulations, including permitted uses, bulk regulations (lot size, building density, setback lines, building height), parking and loading requirements and sign restrictions, (c) provisions for the application of specialized zoning regulations to particular properties (Planned Unit Developments), and (d) general provisions for amending and enforcing the zoning code. Zoning ordinances aim to create a rational pattern of residential, commercial, manufacturing, industrial and agricultural development within the municipality or county.

Land located outside the limits of cities and incorporated towns is governed by the county's

zoning ordinance, if one exists.<sup>1</sup> Moreover, if a municipality has not adopted a zoning ordinance, the county's zoning regulations will apply within the limits of that municipality. When neither the municipality nor the county has adopted a zoning ordinance, another municipality, which has implemented a zoning ordinance, may impose its zoning restrictions on such municipality provided the non-zoned municipality is (a) contiguous to the imposing municipality, and (b) located not more than one and a half miles beyond its corporate limits.<sup>2</sup> When neither a county nor a municipal zoning ordinance is in effect, a township zoning ordinance may apply.<sup>3</sup>

In commercial real estate transactions, purchasers and lenders customarily request assurances that the property in question complies with local zoning regulations. Some purchasers or lenders may desire such affirmative assurances from an attorney opinion letter<sup>4</sup>, a device which provides general assurances that the attorney made the requisite inquiry (due diligence) and analysis prior to opining whether there will be any zoning problems associated with the transaction. Another form of assurance is the zoning endorsement issued by title insurers. A detailed explanation of zoning endorsements and their limitations appears below.

### **II. Coverage Contained in the Policy Jacket**

Generally, when insuring commercial property, title insurers issue the American Land Title Association ("ALTA") 1992 policy jacket. The jacket specifically excludes from coverage loss or damage arising by reason of "[a]ny 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 improvements now or hereafter erected on the land...".<sup>5</sup> Since zoning assurances are not contained within the standard ALTA title policy, zoning endorsements are typically requested as valuable supplemental assurances to the title policy.

### III. Types of Available Zoning Coverage

Lenders and purchasers of unimproved commercial property typically request the ALTA Endorsement Form 3 ("ALTA 3.0"), as set forth in Exhibit A. The ALTA 3.0 aids the lender and purchaser in verifying the value of the property and evaluating whether the land can be used for the desired purpose. This endorsement is frequently requested by lenders for vacant property before construction plans and specifications are finalized to provide assurances, at minimal cost, that an intended use will be permitted. The ALTA 3.0 provides assurances as to the current zoning classification of the land, and the specific permitted uses in that zoning district. The exact form of these assurances, and the limitations thereon, will be described below in Sections V and VI.

Lenders and purchasers of properties improved with completed structures generally request the ALTA Endorsement Form 3.1 ("ALTA 3.1"), as set forth in Exhibit B. This endorsement provides assurances that the existing structure complies with bulk regulations and serves to bolster the attorney opinion letter. The ALTA 3.1 assures lenders that the existing structure and borrower's contemplated use will conform to the current zoning laws, thereby supporting the likelihood of sufficient cash flow for borrower to pay principal and interest on the mortgage. Thus, the ALTA 3.1 provides all of the assurances found in the ALTA 3.0, and also provides assurances with respect to bulk regulations. See Sections V and VI below for the exact form of these assurances and the limitations thereon.

Due to the nature of some commercial real estate transactions, lenders and purchasers may require additional assurances not included in the standard ALTA 3.1. Typical modifications to the ALTA 3.1 endorsement include assurances that the "number of

parking spaces" or the "number of loading docks" on the land complies with the applicable zoning ordinance. Furthermore, additional modifications, such as the 3.1 Endorsement Based on Plans and Specifications, are available. This endorsement is typically requested for properties on which new construction is contemplated. Prior to commencing or completing construction, developers and construction lenders often request assurances from the title company that the development project will comply, upon completion, with the applicable zoning ordinance. This zoning examination, prior to construction, can save developers and lenders time and money if the proposed development fails to comply with the zoning ordinance requirements.<sup>6</sup> In order to issue a 3.1 Zoning Endorsement Based on Plans and Specifications, the title insurance company will review the plans and specifications of the proposed structure, particularly the site-plan created by the designing architect or engineer. The architect's zoning calculations may also be required.

In evaluating whether the proposed structure conforms to the requirements of the designated zoning classification, the endorsement treats the proposed structure as if it were already completed pursuant to the plans. As set forth in Exhibit C, the coverage afforded in the 3.1 Endorsement Based on Plans and Specifications will be conditioned upon the actual development conforming to the plans.

### IV. Zoning Endorsement Requirements

In order for the title insurance company to evaluate the availability of the zoning endorsement for a parcel of property, various clearance materials must first be furnished. Prior to issuing an ALTA 3.0, the following items are required:

1. A description of the present and intended uses of the land, preferably in writing;
2. If applicable, certified copies of special uses or variances, together with evidence of compliance with any requirements contained in the zoning ordinance or in the special use permit or variance;
3. Copies of any zoning ordinances that specifically deal with the property in question, such as Planned Unit Development ordinances; and

4. If the property has been recently annexed, copies of notices and transcripts of hearings and evidence of compliance with the applicable ordinances and statutes.

Prior to issuing an ALTA 3.1, the following additional items are required:

5. A current survey, certified to the title insurance company and drawn to ALTA or Illinois Land Title Association (“ILTA”) standards;
6. If the uses or improvements are nonconforming, that is, not meeting current zoning standards, proof of the date on which the use was established or the date on which all portions of the improvements were completed; and
7. If coverage with respect to the number of parking spaces or loading docks is desired, a statement as to the number of on-site spaces or docks. A surveyor’s certification may also be required.

## **V. Assurances Provided By Zoning Endorsements**

While the first two provisions of the standard ALTA 3.0 and 3.1 zoning endorsements are identical, the coverage provided by the two endorsements differ in significant respects. The first provision states: “ACCORDING TO APPLICABLE ZONING ORDINANCES AND AMENDMENTS THERETO, THE LAND IS CLASSIFIED ZONE ~”. This provision insures the Insured as to the classification of the land by naming the applicable zoning district.

The second provision states:

“THE FOLLOWING USE OR USES ARE ALLOWED UNDER THAT CLASSIFICATION SUBJECT TO THE COMPLIANCE WITH ANY CONDITIONS, RESTRICTIONS OR REQUIREMENTS CONTAINED IN THE ZONING ORDINANCES AND AMENDMENTS THERETO, INCLUDING BUT NOT LIMITED TO THE SECURING OF NECESSARY CONSENTS OR AUTHORIZATIONS AS A PREREQUISITE TO THE USE OR USES ...”

Under this provision, the endorsements list the specific land uses permitted in the applicable

zoning district. It is a common misconception that the zoning endorsement insures that the current or proposed use of the property complies with zoning requirements. Rather, the endorsement merely provides information as to the land uses that are permitted in the zoning district.

The 3.0 coverage is limited to the above provisions, but the ALTA 3.1 provides a more expansive coverage by addressing further concerns. In the ALTA 3.1, the next paragraph states:

“THE COMPANY FURTHER INSURES AGAINST LOSS OR DAMAGE ARISING FROM A FINAL DECREE OF A COURT OF COMPETENT JURISDICTION

(A) PROHIBITING THE USE OF THE LAND, WITH ANY STRUCTURE PRESENTLY LOCATED THEREON, AS SPECIFIED IN PARAGRAPH 1(B); OR

(B) REQUIRING THE REMOVAL OR ALTERATION OF THE STRUCTURE ON THE BASIS THAT, AT DATE OF POLICY, THE ORDINANCES AND AMENDMENTS THERETO HAVE BEEN VIOLATED WITH RESPECT TO ANY OF THE FOLLOWING MATTERS:

(1) AREA, WIDTH OR DEPTH OF THE LAND AS A BUILDING SITE FOR THE STRUCTURE;

(2) FLOOR SPACE AREA OF THE STRUCTURE;

(3) SETBACK OF THE STRUCTURE FROM THE PROPERTY LINES OF THE LAND; OR

(4) HEIGHT OF THE STRUCTURE.”

This paragraph insures that the structures on the land are in compliance with the zoning ordinance for the four above stated matters. For example, when preparing an ALTA 3.1 endorsement for an Owner’s policy, the title insurer miscalculates the requisite setbacks. The endorsement issues without any exception for non-compliance. In actuality, the building is not in compliance with the applicable zoning ordinance. Should the zoning authority prohibit the Insured’s use of the property or require the removal or alteration of the structure based on

the setback violation, the title company may incur liability under the terms of the endorsement and Policy.

## VI. Exclusions from Coverage

While zoning endorsements add certain coverages, these additional coverages are often limited. The ALTA 3.0 and 3.1 contain provisions which expressly limit the liability of the title insurer. In the first limiting provision, the title insurer is not liable for any loss arising from an invalid ordinance until a court of competent jurisdiction determines that the zoning ordinance is invalid. For example, the title insurer, after review of municipality X's zoning ordinance, issues an ALTA 3.1. Two years later, neighbors file a court action questioning the validity of the zoning ordinance and thereby threatening the continued use of the structure on the insured land. The insured files a claim with the title insurer. The title insurer will only be liable for damages to the Insured if a court of competent jurisdiction issues a final order determining that the zoning ordinance is invalid and that the current use must be terminated.

The second limiting provision of the endorsements excludes coverage for loss or damage sustained "by reason of the refusal of any person to purchase, lease or lend money" on the property. This provision relieves the title insurer of any liability arising from claims that the land is "unmarketable" due solely to its zoning designation on the date of the policy. To illustrate, a title insurer issues an ALTA 3.1 which classifies the land as C-2: General Commercial District. In reality, the property is zoned C-1: General Commercial District, a more

restrictive district which will not allow the intended use. If a proposed purchaser or lender refuses to consummate a transaction with the Insured because of the existing zoning designation, any loss or damage arising from such refusal will not be covered by the endorsement.

## VII. Conclusion

Zoning issues play an intricate role in the real estate transaction. The implications of zoning are vast and onerous to some real estate practitioners. It is important for one to maintain knowledge in the field, to stay abreast on current developments in the law and pertinent pending legislation. Through zoning endorsements, title companies may alleviate some of the anxiety by providing limited zoning coverage and aid in traversing the difficult terrain of the twilight zone. While zoning endorsements do not provide complete assurances, they are a valuable asset on which purchasers and lenders may rely.

### NOTES:

<sup>1</sup> See generally 55 ILCS 5/5-12001 *et seq.* relative to county zoning powers and 65 ILCS 5/11-13-1 *et seq.* Relative to municipal zoning powers.

<sup>2</sup> See generally 65 ILCS 5/11-13-1.

<sup>3</sup> See generally the Township Zoning Act 60 ILCS 1/110/5-5 *et seq.*

<sup>4</sup> For a more detailed discussion regarding the merits of attorney opinion letters, see generally, L. Preble, M. Scott *et al.* Legal Opinions in California Real Estate transactions, 42 BUS. LAW.

<sup>5</sup> The American Land Title Association Exclusions from coverage paragraph 1(a), (emphasis added).

<sup>6</sup> Should the development not comply with the zoning code, the municipality has the ability to stop the construction by refusing to issue the building permits or by requesting a court to enjoin the construction.

Exhibit A

**ENDORSEMENT**

ATTACHED TO AND FORMING A PART OF  
POLICY NUMBER

ISSUED BY

**CHICAGO TITLE INSURANCE COMPANY**

**ALTA ENDORSEMENT FORM 3**

THE COMPANY INSURES THE INSURED AGAINST LOSS OR DAMAGE BY REASON OF ANY  
INCORRECTNESS IN THE ASSURANCE THAT, AT DATE OF POLICY:

1. ACCORDING TO APPLICABLE ZONING ORDINANCES AND AMENDMENTS THERETO,  
THE LAND IS CLASSIFIED ZONE ~;
  
2. THE FOLLOWING USE OR USES ARE ALLOWED UNDER THAT CLASSIFICATION  
SUBJECT TO COMPLIANCE WITH ANY CONDITIONS, RESTRICTIONS OR REQUIREMENTS  
CONTAINED IN THE ZONING ORDINANCES AND AMENDMENTS THERETO, INCLUDING  
BUT NOT LIMITED TO THE SECURING OF NECESSARY CONSENTS OR AUTHORIZATIONS  
AS A PREREQUISITE TO THE USE OR USES:

THERE SHALL BE NO LIABILITY UNDER THIS ENDORSEMENT BASED ON THE INVALIDITY OF THE  
ORDINANCES AND AMENDMENTS THERETO UNTIL AFTER A FINAL JUDGMENT OF A COURT OF  
COMPETENT JURISDICTION ADJUDICATING THE INVALIDITY, THE EFFECT OF WHICH IS TO PROHIBIT  
THE USE OR USES.

LOSS OR DAMAGE AS TO THE MATTERS INSURED AGAINST BY THIS ENDORSEMENT SHALL NOT  
INCLUDE LOSS OR DAMAGE SUSTAINED OR INCURRED BY REASON OF THE REFUSAL OF ANY PERSON  
TO PURCHASE, LEASE OR LEND MONEY ON THE ESTATE OR INTEREST COVERED BY THIS POLICY.

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

Exhibit B

**ENDORSEMENT**

ATTACHED TO AND FORMING A PART OF  
POLICY NUMBER

ISSUED BY

**CHICAGO TITLE INSURANCE COMPANY**

ALTA ENDORSEMENT FORM 3.1

1. THE COMPANY INSURES THE INSURED AGAINST LOSS OR DAMAGE SUSTAINED BY REASON OF ANY INCORRECTNESS IN THE ASSURANCE THAT, AT DATE OF POLICY:

(A) ACCORDING TO APPLICABLE ZONING ORDINANCES AND AMENDMENTS THERETO, THE LAND IS CLASSIFIED ZONE ~;

(B) THE FOLLOWING USE OR USES ARE ALLOWED UNDER THAT CLASSIFICATION SUBJECT TO COMPLIANCE WITH ANY CONDITIONS, RESTRICTIONS OR REQUIREMENTS CONTAINED IN THE ZONING ORDINANCES AND AMENDMENTS THERETO, INCLUDING BUT NOT LIMITED TO THE SECURING OF NECESSARY CONSENTS OR AUTHORIZATIONS AS A PREREQUISITE TO THE USE OR USES:

2. THE COMPANY FURTHER INSURES THE INSURED AGAINST LOSS OR DAMAGE ARISING FROM A FINAL DECREE OF A COURT OF COMPETENT JURISDICTION:

(A) PROHIBITING THE USE OF THE LAND, WITH ANY STRUCTURE PRESENTLY LOCATED THEREON, AS SPECIFIED IN PARAGRAPH 1B; OR

(B) REQUIRING THE REMOVAL OR ALTERATION OF THE STRUCTURE ON THE BASIS THAT, AT DATE OF POLICY, THE ORDINANCES AND AMENDMENTS THERETO HAVE BEEN VIOLATED WITH RESPECT TO ANY OF THE FOLLOWING MATTERS:

- (1) AREA, WIDTH OR DEPTH OF THE LAND AS A BUILDING SITE FOR THE STRUCTURE;
- (2) FLOOR SPACE AREA OF THE STRUCTURE;
- (3) SETBACK OF THE STRUCTURE FROM THE PROPERTY LINES OF THE LAND; OR
- (4) HEIGHT OF THE STRUCTURE.

THERE SHALL BE NO LIABILITY UNDER THIS ENDORSEMENT BASED ON THE INVALIDITY OF THE ORDINANCES AND AMENDMENTS THERETO UNTIL AFTER A FINAL JUDGMENT OF A COURT OF COMPETENT JURISDICTION ADJUDICATING THE INVALIDITY, THE EFFECT OF WHICH IS TO PROHIBIT THE USE OR USES.

LOSS OR DAMAGE AS TO THE MATTERS INSURED AGAINST BY THIS ENDORSEMENT SHALL NOT INCLUDE LOSS OR DAMAGE SUSTAINED OR INCURRED BY REASON OF THE REFUSAL OF ANY PERSON TO PURCHASE, LEASE OR LEND MONEY ON THE ESTATE OR INTEREST COVERED BY THIS 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, NOR DOES IT EXTEND THE EFFECTIVE DATE OF THE POLICY AND ANY PRIOR ENDORSEMENTS, NOR DOES IT INCREASE THE FACE AMOUNT THEREOF.

THIS ENDORSEMENT IS MADE 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 OF ANY PRIOR ENDORSEMENTS, NOR DOES IT EXTEND THE EFFECTIVE DATE OF THE POLICY AND ANY PRIOR ENDORSEMENTS, NOR DOES IT INCREASE THE FACE AMOUNT THEREOF.

Exhibit C

**ENDORSEMENT**

ATTACHED TO AND FORMING A PART OF  
POLICY NUMBER

ISSUED BY

**CHICAGO TITLE INSURANCE COMPANY**

**ZONING ENDORSEMENT FORM 3.1 (MODIFIED 6) (PLANS AND SPECS)**

1. THE COMPANY INSURES THE INSURED AGAINST LOSS OR DAMAGE SUSTAINED BY REASON OF ANY INCORRECTNESS IN THE ASSURANCE THAT, AT DATE OF POLICY:
  - (A) ACCORDING TO APPLICABLE ZONING ORDINANCES AND AMENDMENTS THERETO, THE LAND IS CLASSIFIED ZONE ~;
  - (B) THE FOLLOWING USE OR USES ARE ALLOWED UNDER THAT CLASSIFICATION SUBJECT TO COMPLIANCE WITH ANY CONDITIONS, RESTRICTIONS OR REQUIREMENTS CONTAINED IN THE ZONING ORDINANCES AND AMENDMENTS THERETO, INCLUDING BUT NOT LIMITED TO THE SECURING OF NECESSARY CONSENTS OR AUTHORIZATIONS AS A PREREQUISITE TO THE USE OR USES:
2. THE COMPANY FURTHER INSURES THE INSURED AGAINST LOSS OR DAMAGE ARISING FROM A FINAL DECREE OF A COURT OF COMPETENT JURISDICTION:
  - (A) PROHIBITING THE USE OF THE LAND, WITH ANY STRUCTURE AS CONTEMPLATED AND SET FORTH IN THE PLANS AND SPECIFICATIONS MADE BY DATED, AS SPECIFIED IN PARAGRAPH 1B; OR
  - (B) REQUIRING THE REMOVAL OR ALTERATION OF THE STRUCTURE ON THE BASIS THAT IF THE CONTEMPLATED IMPROVEMENTS WERE COMPLETED ACCORDING TO THE PLANS AND SPECIFICATIONS MADE BY DATED AT DATE OF POLICY, TO-WIT, , THE ORDINANCES AND AMENDMENTS THERETO WOULD HAVE BEEN VIOLATED WITH RESPECT TO ANY OF THE FOLLOWING MATTERS:
    - (1) AREA, WIDTH OR DEPTH OF THE LAND AS A BUILDING SITE FOR THE STRUCTURE;
    - (2) FLOOR SPACE AREA OF THE STRUCTURE;
    - (3) SETBACK OF THE STRUCTURE FROM THE PROPERTY LINES OF THE LAND; OR
    - (4) HEIGHT OF THE STRUCTURE.

THERE SHALL BE NO LIABILITY UNDER THIS ENDORSEMENT BASED ON THE INVALIDITY OF THE ORDINANCES AND AMENDMENTS THERETO UNTIL AFTER A FINAL JUDGMENT OF A COURT OF COMPETENT JURISDICTION ADJUDICATING THE INVALIDITY, THE EFFECT OF WHICH IS TO PROHIBIT THE USE OR USES.

LOSS OR DAMAGE AS TO THE MATTERS INSURED AGAINST BY THIS ENDORSEMENT SHALL NOT INCLUDE LOSS OR DAMAGE SUSTAINED OR INCURRED BY REASON OF THE REFUSAL OF ANY PERSON TO PURCHASE, LEASE OR LEND MONEY ON THE ESTATE OR INTEREST COVERED BY THIS 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, NOR DOES IT EXTEND THE EFFECTIVE DATE OF THE POLICY AND ANY PRIOR ENDORSEMENTS, NOR DOES IT INCREASE THE FACE AMOUNT THEREOF.

THIS ENDORSEMENT IS MADE 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 OF ANY PRIOR ENDORSEMENTS, NOR DOES IT EXTEND THE EFFECTIVE DATE OF THE POLICY AND ANY PRIOR ENDORSEMENTS, NOR DOES IT INCREASE THE FACE AMOUNT THEREOF.