DEVELOPMENT NEWS

Freeborn & Peters LLP

# Trend Report: Development Issues Our Clients Are Talking About

**CLIENT ALERT: ILLINOIS BANKRUPTCY COURT CASE THAT AFFECTS MORTGAGES**

Recently, the United States Bankruptcy Court for the Central District of Illinois decided the case of *Crane vs. The Gifford State Bank*, in which the Court allowed the borrowers' Chapter 7 trustee to avoid two mortgages on Illinois properties because the mortgages did not include a statement of the interest rate applicable to the indebtedness or the maturity date. In reaching its decision, the Court considered the language of 765 ILCS 5/11 and concluded that the "elements" of a mortgage recited in the statute are mandatory, i.e., required for a mortgage valid against third parties such as a bankruptcy trustee, rather than permissive. The elements are (i) the amount of the indebtedness, (ii) the interest rate and (iii) the maturity date. In our experience, mortgages typically include statements of the amount secured and the maturity date but incorporate the applicable interest rate by referring to the promissory note or credit agreement, neither of which is part of the recorded document.

We do not necessarily agree with the Court's decision or its characterization of 765 ILCS 5/11, but, for now, we recommend that our lender clients include in their new Illinois mortgages and mortgages that are being amended for other reasons all of the statements set forth in the statute. The amount of secured indebtedness and maturity date should be stated in the body of the mortgage (keeping in mind that the amount of indebtedness should be the maximum principal amount that may be borrowed under the loan, and the loan documents may grant to the borrower a right under certain circumstances to extend the maturity date). When feasible, we also believe the interest rate should be stated in the body of the mortgage. However, stating the interest rate in the body of the mortgage may not be feasible or desirable in cases where the interest rate is complex, i.e., makes use of indexes, formulas, extensive defined terms and the like. In such cases we believe it should be sufficient to (a) attach a copy of the promissory note to the mortgage or (b) state the interest rate provisions in a rider or exhibit to the mortgage and incorporate them in the mortgage by reference. If interest rate provisions from other documents (such as the promissory note or credit agreement) are incorporated in the mortgage, care should be taken to insure that the incorporated provisions are consistent with their source documents and also that the provisions incorporated include any defined terms (which may be located in different sections of the source documents) that are material to the interest rate. Also, consideration should be given to default rates and charges, which may need to be included if they are stated as "interest", and to the lender's rights to participate in cash flow and/or appreciation, which also may constitute "interest". For mortgages that secure indirect or unliquidated obligations, such as guarantees and indemnity agreements, other approaches may be necessary, as determined on a case-by-case basis.

We also recommend for mortgage amendments that the lender consider requiring a date down of its title insurance policy.

**RETHINKING WAIVERS OF COVENANTS TO CONSTRUCT**

In retail developments, developers and anchor occupants have always argued about whether the anchor has the obligation to open for business, continuously operate or even construct its improvements. In the last few years, with the economy heavily favoring occupants, many anchors have strongly resisted any covenant to open or continue to conduct business operations. However, at a minimum, developers should ensure that such occupants have the obligation to construct certain improvements that are integral to the operation of the shopping center regardless of whether the occupant ever opens at the development. Allowing an occupant to simply cease construction irretrievably ties up any developer who has entered into agreements with other occupants who rely upon the construction of integral site work in order to operate. Since partial recourse and full recourse financing is now in vogue, developers should be well apprised to make sure that such covenants to construct exist in their shopping center agreements.

**NEW CHICAGO REAL ESTATE TRANSFER RULES: A HEADACHE FOR SOME, NEW BUSINESS FOR OTHERS**

In order to convey real property in Chicago, certain burdensome transfer requirements must be met, including the payment of transfer taxes, applying for and obtaining a Full Payment Certificate

from the Department of Water, and the filing of certain forms along with the deed. Historically, certain categories of conveyances were deemed to be “exempt” from these onerous requirements; specifically, conveyances that are exempt from transfer taxes, such as transfers by way of a judicial sale or a deed-in-lieu of foreclosure.

Recently, however, the rules were changed with regard to exempt transfers. Effective January 1, 2012, the City of Chicago amended its municipal code (Section 11-12-530), so that Full Payment Certificates from the Department of Water are now required for ALL transfers, including exempt transfers.

On its face, this new requirement does not sound overly onerous. However, in order to obtain the Full Payment Certificate, a party needs to complete the requisite applications, pay a small application fee, and schedule a meter reading with the Department of Water—all tasks that can only be completed by going to the Department of Water in person and waiting, sometimes hours, for assistance. If the property consists of multiple parcel identification numbers, is a corner lot or includes new construction, the field review department of the Water Department will also need to review the paperwork, which typically adds another 7-10 days to the process.

After the final meter reading is performed, full payment will be required within a matter of a few days or the process will need to be started over.

Prior to promulgation of the municipal code amendment, parties to real estate conveyances in the City of Chicago could expect to have a water meter reading performed and a Full Payment Certificate issued within two or three weeks. Currently, however, ***due to the increased volume of additional properties that now require Full Payment Certificates, the Department of Water is severely backlogged and parties are lucky if they can get their Full Payment Certificates turned around within five or six weeks of application***. Because the deed cannot be recorded without the Full Payment Certificate attached, these backlogs frequently hold up real estate closings. Accordingly, it is critical that parties to transactions involving the conveyance of real property located in the City of Chicago submit their paperwork as early as possible.

In the case of judicial foreclosures, the process for obtaining a Full Payment Certificate is often further delayed due to the nature of the relationship of the lender who is foreclosing on the property, and the mortgagor who is being foreclosed upon. It is not uncommon for an unhappy mortgagor to refuse to cooperate with the lender to set a meter reading time or to allow the Department of Water to enter the premises.

If the property is being conveyed by way of a deed-in-lieu or consent foreclosure, the title company will usually handle the coordination of the Full Payment Certificate. In order to support this effort, each of the title companies in Chicago has retained the services of third-party service providers whose sole jobs are to sit at the Department of Water and complete the paperwork necessary for issuance of Full Payment Certificates. These service providers can also be engaged by parties to non-foreclosure sale transactions to help coordinate and expedite the process. In any case, the earlier the process can be initiated, the better.

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