



**REAL**  
**PROTECTION** **FOR**  
**REAL**  
**ESTATE**

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## about this book

This book instructs real estate investors on simple steps that they can take to avoid purchasing a property that will cause the investor to suffer losses or to incur legal liability arising from the property. This book also informs investors on how to minimize the likelihood that they will be sued successfully for claims arising from their property, and this book empowers investors to protect their personal assets from being reached to satisfy legal claims that may arise from their property.

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# **I. PERFORM DUE DILIGENCE IN TRANSACTIONS**

The first step that real estate investors can take to protect their real estate assets is to ensure that the properties they purchase do not have existing conditions that may give rise to future liabilities. An investor may believe mistakenly that retaining an attorney to close on the property, procuring a title and homeowner's insurance policy, having a home and environmental inspection, and having the property appraised are sufficient to ensure that the investor is protected from future liabilities arising from existing conditions. Although these procedures may cause an investor to learning of many disadvantageous conditions relating to the property, they are not sufficient for the investor to discover all disadvantageous conditions.

Many of the procedures typically employed in real estate purchase transactions are designed to serve purposes of persons other than the investor. The standard procedures may give the investor the false sense that he need not undertake additional steps to protect himself. In addition to employing these standard procedures, the investor should ensure that he takes the additional steps outlined below to investigate the property prior to purchasing it.

If any adverse conditions are discovered by the investor prior to his purchase of the property, then the investor has the opportunity to make an informed judgment as to whether investing in the property is prudent. Moreover, the investor has the opportunity to change the terms of the deal to cause the investment to be a prudent one. Most importantly, if the investor knows of an adverse condition before the investor takes ownership of the property, then the investor can take measures to protect against future liabilities that may arise from the condition.

## *A. INTERVIEW KNOWLEDGEABLE PEOPLE*

Investors typically rely on a property inspector to report to the investor any problems with the condition of the premises, and property inspections are a useful mechanism to learn about certain conditions of the premises. However, a property inspector's analysis typically reflects only the physical conditions that are visible at the premises at the time of the inspection. All other conditions will not be revealed by the inspection. Therefore, an investor should endeavor to do a more extensive investigation of the premises to attempt to discover additional information about adverse physical conditions and violations of laws that relate to the property.

An investor often can discover adverse information about the property by communicating extensively with people who have personal knowledge about the property. The investor should start by engaging the seller and the real estate agent in detailed conversations about the property. The seller and the real estate agent often have no affirmative duty to disclose information to the investor. However, they always are prohibited from making false statements about the property. Thus, by forcing the seller and the real estate agent to make statements about the property by asking questions, the investor not only can learn useful information about the property, but also the investor bolsters his ability to successfully prosecute a legal claim against the seller and/or realtor if the property's condition is not as it was represented to be.

The investor also should seek information from other individuals who know about the property, such as prior owners, neighbors, tenants, and property managers. These people typically have no interest in the sales transaction, and therefore, they are often fruitful sources of useful information about the condition of the property. The identity of prior owners of the property is usually available in the public records relating to the property on file with the county recorder of deeds.

## *B. PERFORM A THOROUGH INSPECTION*

In addition to talking to people about the property, the investor also should inspect the premises with a home inspector and other professionals to discover adverse conditions about the property. The inspection should focus on (1) hazardous conditions at the property; (2) conditions that may violate municipal ordinances or other laws; and (3) conditions that may affect the investor's title to the property.

## Hazardous Conditions

An investor should ensure that the inspection covers physical attributes of the property that may cause physical injuries, death or extensive property damage. For example, the condition of the electrical wiring and circuit breakers or fuses should be assessed to determine if they pose a fire hazard. The presence of flammable materials or debris near furnaces or other heat sources should be noted. The presence of hazardous substances such as lead paint or mold also should be determined. All structural elements of the premises should be analyzed to ensure that there is no risk of them collapsing or breaking. The elements that often pose the greatest amount of risk are stairways with rotted wood, slick surfaces, or without handrails; pavement with cracks, uneven levels or holes; handrails that are insecurely fastened; porches that cannot withstand expected loads; and guardrails with insufficient strength. All systems that help prevent physical injuries or death to individuals at the premises also should be assessed, such as lighting systems that illuminate potentially dangerous areas; signs that warn individuals of hazards; smoke and carbon monoxide detectors; and security systems such as alarms, locks, fences and window bars. Finally, it is extremely important that exit routes be assessed to ensure that the premises can be exited quickly through multiple routes. Particularly troublesome are window bars that cannot be penetrated from inside the premises, locks on exit doors that require a key to open, and structures or objects obstructing exit paths or doors.

## Violations of Codes

The investor should also ensure that the inspection includes determining whether any conditions at the property violate the municipal building codes or zoning ordinances. Typically, an investor will be allowed to close on the purchase of a property even if building code violations and zoning ordinance violations exist. For example, a seller of property in the City of Chicago is not required to prove compliance with the building codes for a sale of the property to be consummated unless the real estate purchase contract requires such proof. Likewise, a seller is not required to prove compliance with the zoning ordinances to consummate a sale of certain types of properties, such as condominium units or commercial properties. Therefore, the investor should retain experts to determine whether violations of municipal codes or ordinances exist rather than relying on the sale process to ensure that no violations exist.

## Conditions Affecting Title

Finally, the investor should ensure that the investigation includes identifying physical structures that may constitute an encroachment, that may reflect the existence of a boundary line dispute, or that may reflect structures that were constructed without authorization from local authorities. A seller is typically required to present a survey to the buyer at a real estate closing, which may reveal the existence of encroachments or boundary line disputes. However, the survey often is prepared months prior to the

closing, and therefore, may not reveal structures constructed since the date of the survey. In addition, the survey typically is limited to depicting the location of the structures on the lot in general and does not depict the interior units or other divisions within the building. Therefore, the survey will not reflect encroachments of one unit or division upon another. In addition, the survey will reflect only the existing physical structure and will not reflect variances between the existing structure and the structure as it was authorized to be built by the local authorities.

The investor cannot necessarily rely on his title insurance policy to protect him or her against these sorts of title problems. Title insurance policies typically do not protect the investor against problems with title that arise from conditions at the property that are observable. Most title insurance policies contain an express exception for “encroachments, overlaps, boundary line disputes, or other matters which would be disclosed by an accurate survey and inspection of the premises.” In addition, most real estate lawyers do not visit the property in representing an investor in purchasing a property, and therefore, they will not be able to identify and protect the investor against particular problems that may exist.

Therefore, it is important for the investor to perform with qualified professionals a physical inspection of the property to ensure that he is protected. The investor should ensure that structures are identified that may constitute an encroachment or that reflect the existence of a boundary line dispute. For example, if a sidewalk or fence that relates to the property appears to be on the neighbor’s lot or vice versa, the investor should inform his lawyer of this.

The investor also should ensure that the existing physical structure is consistent with any plats, surveys, or construction plans for the property. If structures physically exist that are not present on the plats, surveys, or construction plans or vice versa, the investor also should inform his lawyer of this.

### *C. REVIEW RECORDS*

In addition to investigating the condition of the property, an investor also should review the public records and records in the seller’s possession relating to the property to discover any problems that exist with the property. There are at least five types of records that could reveal important information about a property that should be examined.

## Recorder of Deeds Records

The first type of records that should be reviewed is documents recorded with the recorder of deeds for the county in which the property is located. These documents include documents that may affect the legal title to the property and other documents. These records typically include deeds transferring title to the property, mortgages that are secured by the property, judgments relating to the property, liens filed against the property, memoranda of leases of the property, assignments of the rents from leases of the property, sales contracts relating to the property, and the declaration, bylaws, and plat for condominiums.

The title insurance company from whom the investor purchases title insurance will review these publicly recorded documents as well. If any of the documents reflect that the investor may not have good title to the property he purchases, then the title company will include an exception in the investor's title insurance policy and the investor will not be insured for these items. If the investor is obtaining financing from a bank to purchase the property, the bank will demand that certain types of exceptions be resolved and removed from the title insurance exceptions before the bank commits to provide the financing for the purchase. In addition, the real estate attorney retained by the investor to represent him in the purchase transaction typically will review the exceptions contained in the title insurance policy to ensure that the investor is receiving good title to the property.

However, the investor should not rely exclusively on this process to discover issues relating to the property. There may be additional public records on file with the recorder of deeds that reveal information about the property that is important to the purchaser but are of no concern to the title company or to the bank. This information either will not be reported in the title policy or will not be requested to be removed as an exception to the policy by the investor's bank. Therefore, unless the investor or his lawyer reviews the records on file with the recorder of deeds rather than relying exclusively on the title policy and the bank's examination of it, the investor will not learn of adverse conditions relating to the property.

## Building Code Records

The second type of records that should be reviewed is the records maintained by the municipal department that enforces the building codes. These public records typically reveal any citations of building code violations that have been issued relating to the property and the resolution of them. However, the absence of these public records does not necessarily mean that no building code violations exist. Rather, the absence of these records may result from a failure by the municipality to inspect the property for violations. Therefore, it is important for the investor to make an independent assessment of whether violations exist at the property.

The public records maintained by the municipal department also typically reveal any building permits that have been issued for construction at the property. It is important to verify that a building permit exists authorizing the construction of all structures that

exist at the property for which the law would have required a building permit. It also is important to verify that the structures were not built differently than authorized by the building permit or subsequently altered.

If code violations or unauthorized construction exists at the premise, the investor could face liability in an action by the municipality even if the conditions existed prior to the investor's purchase of the property. Therefore, it is important for an investor to discover if these conditions exist prior to purchasing the property. It is also important for the investor to know that in the standard process for closing real estate transactions, no one typically examines the records relating to code violations and permits on file with the municipality. Thus, the investor should either review these records himself or specifically request that his attorney do so.

Finally, the property may be required to be registered with the municipality where it is located. For example, buildings with four or more dwelling units typically must be registered with the City of Chicago, Department of Buildings. If the property is a type that is required to be registered, the investor should verify that the registration exists.

## Zoning Ordinance Records

The third type of public records that should be reviewed is the records maintained by the zoning department of the municipality where the property is located. The zoning department publishes the zoning classification that applies to property sites. Typically, the zoning department also records the characteristics of the structure existing at the site. The investor should ensure that the existing structure satisfies the requirements of the zoning classification that applies to the site. For example, if the existing structure is a retail store with three stories, 5,000 square feet, and two parking spaces, then the investor should ensure that the zoning classification applicable to the property site permits this type of structure. In addition, the investor should ensure that the zoning department's records reflect that this type of structure is currently present at the site.

Unless the seller is required by the title company to present a certification of zoning compliance at closing, the zoning of the property is typically not checked during the standard real estate closing process. Thus, to avoid unexpected liabilities, the investor should either check the zoning records himself to ensure that the property complies with the zoning ordinances or he should retain his attorney to do so.

## Property Tax Records

The fourth type of records that should be examined is the records maintained by the assessor and the collector of real estate taxes for the county in which the property is located. Information published by the assessor will typically include the assessed value of the property and the township in which the property is located. This information will allow the investor to predict whether the property taxes will increase as a result of his purchase of the property and to know when the property taxes will be reassessed for the property. For example, in townships in Cook County, the property taxes are reassessed every three years. Although they can be reassessed at other times, including as a result of

a sales transaction, an investor can expect a significant increase resulting from a reassessment beginning every third year. The investor also can expect a modest increase from year to year as well.

The county treasurer who collects the real estate taxes also typically publishes the payment history for the property taxes and the exemptions that applied. A review of these records will assist the investor to ensure that the seller pays the investor at closing the proper amount of taxes that the investor will pay in the future to the treasurer for the taxes assessed for the period that the seller owned the property. In addition, these records will assist the investor in predicting whether the taxes will increase or decrease as a result of changes in applicable exemptions relating to the property. For example, if the current owner is receiving a senior citizen exemption but the investor does not qualify for this exemption, then the investor should anticipate that the investor's property taxes will be higher than the seller's taxes.

## Condominium Records

In an ideal situation, an investor would demand from the seller all records that the seller has pertaining to the property and review these records to learn information about the property prior to purchasing it. Unfortunately for investors, this is not common practice and investors who demand this information from a seller may have a difficultly consummating a purchase transaction.

However, the situation is different if the investor is purchasing a condominium. The Illinois Condominium Property Act requires a seller of a condominium unit to provide the following documents and information to the investor upon demand:

- 1) The condominium declaration, by-laws, other instruments, and rules and regulations.
- 2) A statement of any liens and unpaid assessments or other charges due and owing to the condominium association.
- 3) A statement of any capital expenditures anticipated by the condominium association within the current or succeeding two fiscal years.
- 4) The financial statement of the condominium association for the last fiscal year.
- 5) The status of any pending suits or judgments in which the condominium association is a party.
- 6) The insurance coverage that is provided by the condominium association.
- 7) A statement that any improvements or alterations made to the unit, or the limited common elements assigned to the unit, by the prior unit owner are in good faith believed to be in compliance with the condominium instruments.
- 8) The identity and the mailing address of the principal officer of the condominium association or the other officer or agent designated to receive notices.

## 765 ILCS §605/22.1

In addition to these documents, an investor should request the minutes of all meeting of the condominium association or its board of managers for the past several years. The minutes often reveal problems that have arisen relating to the condominiums and are a good source of useful information about the condominium for the investor. An investor should review all of the documents received about the condominium to discover any adverse conditions relating to the condominium prior to purchasing it.

## **II.**

# **COMPETENTLY EXECUTE TRANSACTIONS**

The investor should ensure that he retains a qualified and diligent attorney to ensure that provisions are included in the documents governing the transaction to protect the investor adequately. The terms of the real estate purchase contract are essential to ensure that the investor has the legal right to recover from the seller of the real estate if adverse conditions exist relating to the property. The investor should not assume that by using a standard form contract, that adequate protection exists. The investor should be cognizant of at least seven areas that may be problematic in most standard contracts.

### ***A. PROTECT AGAINST ADVERSE PROPERTY CONDITIONS.***

First, standard contracts typically do not give the investor rights to recover against the seller of the property for the costs of repairing or for damages resulting from defects in the physical condition of the property. Instead, the investor typically has the right to cancel the purchase within a set amount of time if the investor does not approve of the condition of the property after the investor inspects it. The investor also may have written representations made to him by the seller stating that the seller has no knowledge of certain types of defects.

If the investor elects to consummate the purchase, the investor typically has no right to recover against the seller of the property for damages arising from defects in the physical condition of the property unless the seller had knowledge of the defect and represented to the investor that the defect did not exist. Sellers also often add a term to the standard contract stating that the property is sold “as is” in order to ensure that the investor has

no rights to recover against the seller for defects in the physical condition of the property. Obviously, it is in the investor's best interest to attempt to change the terms of the standard contract to give the investor greater rights to recover against the seller if defects in the condition of the property exist.

## *B. PROTECT AGAINST CODE VIOLATIONS.*

Second, standard contracts typically do not give the investor the right to recover against the seller if violations of the municipal code or zoning ordinances exist at the property. Instead, standard contracts typically contain only a representation by the seller that the seller has not received any notice from any governmental authority of any code violation relating to the property. This representation provides only limited protection to the investor for code and zoning ordinance violations. Of course, there could be many circumstances in which a building code or zoning ordinance violation exists at the property, but the seller has not received a notice from a governmental authority of the violation. Even if a notice was received by the seller, it may be difficult for the investor to prove that the seller actually received the notice in order to recover from the seller. Therefore, the investor should attempt to change the terms of the standard contract to provide greater protection against municipal code and zoning ordinance violations.

## *C. PROTECT AGAINST UNLAWFUL TENANT LEASES.*

Third, standard contracts typically do not give the investor any right to recover against the seller if the tenant leases relating to the property are unenforceable by the investor against the tenants or cause the investor to incur liabilities to the tenants. For example, leases may be assigned to the investor at closing that violate the applicable landlord and tenant ordinance or other laws. These violations may cause the investor to incur liability to tenants for the violations or permit the tenants to terminate their lease. The tenants also may have the right to terminate their leases as a result of the conduct of the seller or the condition of the property prior to the assignment of the tenant leases to the investor. Thus, the investor should ensure that his lawyer carefully reviews the terms of the tenant leases before the investor obligates himself to purchase the property to ensure that the investor will have enforceable rights against the tenants when the leases are assigned to the investor by the seller. The investor also should attempt to add terms to the standard contract to ensure that the investor has recourse against the seller if the tenant leases are unenforceable or give rise to liabilities as a result of the seller's conduct or the condition of the property prior to the assignment of the leases to the investor.

## *D. PROTECT AGAINST INCREASED TAXES.*

Fourth, standard contracts typically do not protect the investor if the real estate taxes are significantly greater than the last available tax bill. Standard contracts generally provide for the seller to pay to the investor an estimated amount for the unpaid real estate taxes for the period during which the seller owned the property. The estimated tax amount typically is based on the last tax bill available for the property increased by about 5%. However, the investor may be required to pay substantially higher taxes than the estimated amount. This is likely to occur if the taxes for the property have been reassessed since the last tax bill was received. Thus, the investor should protect himself against receiving less from the seller at closing for the unpaid taxes than the investor actually pays to the tax collector. The investor should attempt to have the estimated amount of the taxes to be paid by the seller at closing calculated in a manner such that the estimate likely will not be less than the taxes that the investor will have to pay to the tax collector. The investor can accomplish this by using a higher percentage to be applied to the last tax bill to calculate the estimated taxes, such as 10%. The investor also may change the contract so that the tax estimate is based on either the last tax bill or the most recent tax assessment letter relating to the property, whichever is higher. The investor also may change the contract to require the seller to pay the investor after closing the amount by which the taxes paid to the tax collector by the investor exceeds the amount of the taxes estimated and paid to the investor by the seller at closing.

## *E. PROTECT AGAINST UNCHANGEABLE CONTRACT TERMS.*

Fifth, standard contracts may contain an attorney approval clause that limits the changes that an investor's attorney can make to the contract. Some people mistakenly believe that an attorney approval clause always offers a party to a real estate contract an opportunity to cancel the contract without liability or to change substantially the contract's terms. To the contrary, the attorney approval clause may limit the contract modifications of the investor's attorney to certain subject matters, for example changes to the "form" of the contract or to changes other than purchase price, broker's compensation, and dates. In addition, a limited time period is given for the investor's attorney to propose modifications, and if the investor's attorney fails to propose contract modifications during this specified time, the investor's attorney will have no right to make any modifications. Also, if the seller knows that the investor is attempting to back out of the purchase by using the attorney approval clause, the seller may just accept the modifications proposed by the investor's attorney to ensure that the seller is able to enforce the contract against the investor.

An investor often enters into a contract to purchase a property before involving his attorney. If an investor does so, it is very important that the investor review the attorney approval clause of the contract to ensure that it does not have substantial limitations on the modifications that can be made during the attorney approval period.

If the investor does not do so, the investor's attorney may be powerless to assist the investor in changing the contract terms to adequately protect the investor in the transaction.

## *F. PROTECT FOR PARTICULAR CIRCUMSTANCES.*

Sixth, standard contracts by their very nature may not protect the investor against particular circumstances that exist with respect to the particular property being sold. For example, if a tenant lease is expected to expire before the closing, the investor would want to ensure that he has the right to show the property to prospective tenants or that the seller has the obligation to do so prior to the closing. The investor also may discover specific issues during his inspection and review of the documents relating to the property for which the investor should attempt to obtain protection in the contract.

## *G. PROTECT AGAINST ALL PEOPLE INVOLVED.*

Seventh, the terms contained in standard contracts relate only to the rights between the investor and the seller of the property. For the investor to be adequately protected with respect to his purchase of the property, the investor should ensure that the investor and his attorney also review and attempt to change if necessary the rights and obligations that exist between the investors and persons other than the seller. The investor should ensure that a review is performed of (1) the rights and obligations between the investor and the title insurance company relating to defects in the investor's title to the property, which are contained in the investor's title insurance policy; (2) the rights and obligations between the investor and the investor's lender, which are contained in the mortgage and note; (3) the rights and obligations between the investor and the investor's liability insurance carrier, which are contained in the investor's liability insurance policy; (4) the rights and obligations of the owner pursuant to state and local laws that apply to the property, such as the municipal building code and zoning ordinances; (5) the rights and obligations between the investor and the other professionals who will provide services to the investor in connection with his purchase of the property, such as the investor's home and environmental inspectors; and (6) the rights and obligations between the investor and the condominium association, if any, which are reflected in the condominium documents.

Unless all of the documents that contain rights and obligations that affect the investor are reviewed and altered if necessary, the investor may not be adequately protected with respect to the property. For example, professionals that the investor retains may disclaim or severely limit their liability for their work product. For example, a property inspection reports often contain limitations such as the following:

The parties understand and agree that the inspector assumes no liability or responsibility for the costs of repairing or replacing any unreported defects or deficiencies either current or arising in the future or any property damage, consequential damage or bodily injury of any nature. The client further agrees that the inspector is liable only up to the cost of the inspection. The parties agree and understand that the inspector is not an insurer or guarantor against defects in the structure, items, components, or systems inspected. Inspector makes no warranty, expressed or implied, as to the fitness for use, condition, performance or adequacy of any inspected structure, item, component or system.

If the investor is aware that the inspector that he has retained has severely limited his liability for his services, the investor may want to attempt to negotiate different terms with the inspector or use a different inspector who does not limited his liability.

By reviewing all of the legal documents governing the transaction, the investor also may discover that his lender has the right to charge him a large prepayment penalty for paying off his note early, which would be problematic if the investor intended on refinancing the property after closing. Likewise, the investor may discover that the plans that he had for changing the structure or the use of the property are prohibited by law. It is also possible that the investor may discover that the condominium association prohibits owners from leasing their condominium unit or from having pets, which would be problematic if the investor intends on renting the condominium unit or housing a pet after closing.

In short, an investor should ensure that he has retained the services of a competent real estate attorney who provides comprehensive services to the investor to ensure that the investor is protected adequately with respect to all aspects of the transaction rather than a professional who primarily focuses and relies on the standard form contract to protect the investor.

### **III.**

## **MINIMIZE PREMISE LIABILITY**

A property owner generally is liable for property damage and personal injuries that are caused by the owner's failure to exercise reasonable care under the circumstances with respect to the condition of the property or the acts done or omitted on the property. To reduce his expose to premise liability, an investor should (1) ensure that he has exercised reasonable care with respect to the condition of, and acts relating to, the property, and that the investor can prove that he did so; (2) ensure that he has complied with all municipal codes and other laws for the protection of health and safety relating to the property; and (3) ensure that he uses favorable lease terms to limit his premise liability.

#### ***A. EXERCISE AND DOCUMENT REASONABLE CARE.***

An investor is especially prone to premise liability if it can be proven that the investor knew that a dangerous condition existed at the property and the investor failed to correct the dangerous condition after a reasonable amount of time. Thus, an investor can reduce his exposure to premise liability by promptly correcting dangerous conditions at the property and maintaining contemporaneous records to enable him to prove his reasonable actions. An investor should place the highest priority on conditions at the premises that may cause series personal injury or death to persons at the property. Often other conditions at the property will have a greater immediate impact on a tenant at the property, and therefore, the tenant may demand other conditions to be repaired sooner. For example, a broken clothes dryer may inconvenience the tenant, and therefore, cause the tenant to demand repair to the dryer sooner than demanding that a

loose handrail on the stairs at the property be fixed. However, the repairs to the handrail likely are substantially more important to reduce the investor's potential premise liability, and therefore, the repairs to the handrails should be prioritized despite the tenant's priorities.

If an investor is unable to repair a dangerous condition at the premises promptly, the investor should take steps to render the property safe without completing the repair. For example, sometimes a sign can be placed at the premises warning people of a dangerous condition so that they can protect themselves against it. It also might be possible to physically restrict access to a dangerous area to avoid harm.

Not only is it essential for an investor to act with reasonable care, but also it is essential that he maintain accurate records to enable him to prove that he acted with reasonable care. The investor should make regular inspections of the property and keep a log to document that no defects were observed. It is particularly helpful if the investor takes pictures of the property periodically to prove that no defects were present at the time that the pictures were taken and to prove that mechanisms were in place to protect the safety of persons at the property. For example, the investor should take pictures showing that smoke alarms and carbon monoxide detectors are installed and have a power source.

If a tenant or other person notifies the investor of a dangerous condition at the property, the investor should keep a dated copy of the communication if it was written or a detailed log of the communication if it was oral. The investor should keep detailed records of all actions he takes to correct the dangerous condition and the dates upon which each action was performed. If possible, the investor should have a third party verify that the actions were performed. For example, if a repair is performed by a maintenance company, the investor should keep a record of the name of the repairman and have the repairman specifically note on the invoice that the repair was completed on a specific day and time. The investor also may be able to obtain a statement from his tenant verifying that the repair was completed.

Of course, an investor also must take care in maintaining these records to ensure that they cannot be used against the investor to prove that the investor's conduct was unreasonable. For example, if the investor's photographs depict a dangerous condition at the property, then the investor may be increasing, rather than decreasing, his premise liability by maintaining these records. Thus, the investor should ensure that he exercises reasonable care and that his records reflect only that.

## ***B. COMPLY WITH MUNICIPAL CODES AND OTHER LAWS.***

The municipal laws of the jurisdiction in which a property is located include building codes that establish standards for the construction and condition of buildings and zoning ordinances that establish restrictions on the character, size, and use of structures in a particular location. In addition to municipal ordinances, there may be state and federal statutes that govern the property and the conduct of the investor with respect to it. These laws are relevant to an investor for at least two reasons: (1) an investor's violation of them can bolster a person's premise liability action against the investor; and (2) the investor's violation of them can give rise to an enforcement action against the investor by government authorities.

### **Premise Liability Actions Arising from Violations**

It is particularly important for an investor to discover and to follow all applicable laws that were enacted for the purpose of protecting the health and safety of people at the property in order to minimize the investor's premise liability.

Many of the state and local laws that apply to properties were enacted to protect the health and safety of people at the property. For example, various laws exist that require an investor to disclose the existence of lead based paint at a property. The purpose of this required disclosure is to protect the people at the property from being unknowingly injured from lead based paint.

A person who is injured at the property as a result of the investor's violation of these types of laws may sue the investor for negligence based on the investor's violation of the law. The investor's violation of the law is strong evidence that the investor was negligent. For the investor to be found not liable, the investor must prove that he acted reasonably under the circumstances even though he violated the law. This is a difficult burden to carry. Therefore, it is easier for a person to succeed on a claim against the investor if the investor violated a law applicable to the property than if the investor did not. Thus, it is particularly important for an investor to comply with these laws in order to minimize his exposure to premise liability claims.

## Enforcement Actions

In addition to bolstering a premise liability action against the investor, any investor's violations of the laws applicable to the property may give rise to an action by governmental authorities forcing the investor to correct any existing violation of the laws and imposing penalties for the violation.

Typically, local authorities perform routine inspections of certain property types to ensure compliance with municipal ordinances. For example, the City of Chicago annually inspects residential buildings that consist of four residential units or more and all commercial buildings for building code violations. However, all properties must comply with the municipal ordinances and other applicable laws even if they are not subject to routine inspections.

The also authorities may learn of violations from activities other than inspections. This typically occurs if the enforcement agency receives a complaint from a third party about the property, such as a tenant, a neighbor, or enemy of the owner. Once the authorities learn of a violation, they will send an official notice requiring that the violation be corrected and typically imposing a fine for the violation.

## **IV. EMPLOY GOOD LEASING PRACTICES**

Obviously, tenants are an extremely important component of the success of a property for an investor. Tenants are a source of revenue, but also a potential source of liabilities to the investor. It is essential that an investor employ good leasing practices by (1) complying with laws governing the landlord and tenant relationship; (2) selecting tenants and dealing with them carefully; and (3) ensuring that the investor has enforceable legal rights against tenants.

### *A. COMPLY WITH LANDLORD AND TENANT LAWS.*

Many laws exist for the purpose of protecting residential tenants. An investor who fails to comply with these laws may incur substantial liability for his failure. For example, the landlord and tenant laws often contain substantial monetary penalties that a landlord must pay to tenants for the landlord's violations. In addition, the laws often require the landlord to pay the attorney's fees that the tenant incurs to pursue the tenant's claim against the landlord if the tenant proves that the landlord violated the law.

The landlord and tenant laws vary substantially among different municipalities. Therefore, a landlord must investigate the landlord and tenant laws that apply to his particular property. A landlord can typically do this by contacting a local landlord's association or by obtaining a copy of the relevant laws from the city in which the property is located.

For example, the Chicago Residential Landlord and Tenant Ordinance ("RLTO") applies to every rental agreement for a dwelling unit located in the City of Chicago unless a specified exclusion applies. The most common exclusion is that the RLTO does not

apply, except for one section, to dwelling units in owner-occupied buildings containing six units or less. A landlord can incur substantial liability for claims arising from the RLTO because the RLTO provides for high penalties to be assessed against landlords for violations of the RLTO and provides for tenants to recover their attorneys' fees against landlords if the tenant is successful on his claim.

Some of the provisions of the RLTO are described below. However, a landlord should read the actual text of the entire RLTO to ensure compliance.

## PROVISION

## CONSEQUENCE

**Code Compliance.** A landlord must maintain the property in material compliance with the municipal code and the tenant's lease such that the unit is reasonably fit and habitable.

The tenant can recover damages from the landlord and can terminate his lease after notice and at least 14 days for the landlord to cure. Under certain circumstances, the tenant can correct the complying condition at the landlord's expense or can withhold rent for the reduced value of the unit. Additional remedies are available if the landlord's violation causes immediate danger to the tenant's health and safety or if the landlord fails to provide essential utilities.

**Disclosure of Code Violations.** A landlord must disclose to the tenant in writing before the tenant enters into his lease any (1) code violations cited by the City of Chicago during the previous 12 months, (2) pending code enforcement proceedings, and (3) notice of intent by any utility provider to terminate utility service.

The tenant can terminate his lease and recover one month's rent or actual damages.

**Security Deposits.** A landlord must give the tenant a receipt for the security deposit that states the deposit amount, the name of the recipient and landlord, the date of receipt, a description of the dwelling unit, and the signature of the recipient.

A landlord must hold all tenant security deposits in a federally insured, interest-bearing trust account for the benefit of the tenant at a financial institution in Illinois. The landlord must keep the security deposit separate and cannot commingle the deposit with the landlord's assets.

A landlord must pay interest at the rate specified by the City Comptroller to the tenant on his security deposit and prepaid rent within 30 days after the end of each 12-month rental period.

A landlord must return the balance of the tenant's security deposit and interest thereon within 45 days after the tenant vacates the unit or within 7 days after the tenant terminates his lease. The landlord may deduct from the security deposit unpaid rent and amounts to repair damage to the unit for which the tenant is liable provided that the landlord provide an itemized statement of the damages and costs within 30 days and a paid receipt or certification of the actual repair costs within certain time limits.

**Identification.** A landlord must disclose to the tenant in writing at or before the beginning of the tenancy the name, address, and phone number of the owner or property manager and a person authorized to receive notices for the owner.

**Lease Terms.** A tenant's lease cannot (1) contain a waiver of the RLTO's terms; (2) authorize the confession of judgment; (3) limit any liability arising under law; (4) waive the right to a jury trial; (5) provide for the tenant to pay the landlord's attorneys' fees; (6) provide for one party to terminate the lease at a different time than the other, unless disclosed in a separate written notice; (7) require a tenant to pay a fee in excess of \$10 per month for the first \$500 in rent plus 5% per month for any excess for the late payment of rent; or (8) provide that if the tenant pays rent before a specified date, the tenant receives a discount greater than the amount specified above.

The tenant can recover twice the security deposit plus interest. If the landlord fails to provide a security deposit receipt, the tenant also is entitled to the immediate return of this security deposit.

The tenant can terminate his lease and recover one month's rent or actual damages.

The lease provision is unenforceable. The tenant can recover actual damages and can recover two months rent if the landlord attempts to enforce the provision.

**Summary of RLTO.** A landlord must attach the official summary of the RLTO and security deposit rules to the tenant's lease when initially offered to the tenant.

The tenant can terminate the rental agreement by written notice and can recover \$100 in damages.

**Renewal of Lease.** A landlord cannot require a tenant to renew his lease more than 90 days prior to the termination date of the lease.

For requiring renewal, the tenant can recover one month's rent or actual damages, whichever is greater. For failing to notify of non-renewal, the tenant can remain at the unit for 60 days after notice for the same rent.

A landlord must notify the tenant in writing at least 30 days prior to the termination of the tenant's lease if the landlord does not intend to renew the lease.

**Delivery of Possession.** A landlord must deliver possession of the unit to the tenant in compliance with the lease and the municipal code.

Rent shall abate until possession is delivered. The tenant can terminate his lease or enforce it. For willful conduct, the tenant can recover an amount not more than two months' rent or twice actual damages, whichever is greater.

**Entry.** A landlord must give the tenant no less than two days notice of the landlord's intent to enter the rented unit, except in case of emergency or for practical necessity where repairs or maintenance elsewhere in the building unexpectedly require access provided that the landlord gives the tenant notice of such entry within two days after such entry.

The tenant can (1) terminate the lease and (2) recover up to one month's rent or twice his damages, whichever is greater.

A landlord may enter only at reasonable times except in case of an emergency. Entry between 8:00 a.m. and 8:00 p.m. or at any other time expressly requested by the tenant shall be presumed reasonable.

**Interruption of Occupancy.** A landlord cannot oust or attempt to oust a tenant without authority of law by (1) altering the locks; (2) blocking an entrance; (3) removing a door or window; (4) interfering with utility or other services to the unit; (5) removing the tenant's property; (6) removing or incapacitating appliances; (7) by the use or threat of force; or (8) by rendering the unit inaccessible or uninhabitable.

The landlord shall be fined between \$200 and \$500 per day that the violation occurs. The tenant can recover possession of the unit or his personal property and can recover not more than two months rent or twice his actual damages, whichever is greater.

**Retaliatory Conduct.** A landlord cannot take retaliatory action against a tenant for acts such as reporting code violations, requesting the landlord make repairs, being a member of a tenant's union, testifying about the condition of the property, or exercising any right provided by law.

The tenant can recover possession of the unit or terminate his lease. The tenant also can recover two months' rent or twice his damages, whichever is greater.

In addition to the provisions contained in the RLTO, the City of Chicago Municipal Code contains the following provisions governing property located in Chicago:

**Minimum Heat.** Residential units must be supplied with heat to secure a minimum temperature of 68 degrees from 8:30 a.m. to 10:30 p.m. and 66 degrees from 10:30 p.m. to 8:30 a.m. during the period from September 15 to June 1<sup>st</sup>. Mun. Code Ch. 13-196 §410.

**Heating Cost Disclosure.** If a residential tenant pays for heat, the landlord must disclose to the tenant as part of his lease agreement the average monthly heating cost for the past 12 months and provide the tenant with an official Heating Cost Disclosure Form. Mun. Code Ch. 5-16.

**Smoke Detectors.** Buildings with residential units must have at least one smoke detector in each unit. Mun. Code. Ch. 13-64 and 13-196.

**Carbon Monoxide Detectors.** For residential buildings that use the combustion of fossil fuel for heat, ventilation or hot water, each unit must have at least one carbon monoxide detector. If the building has a central boiler, one carbon monoxide detector by the boiler is required. Mun. Code Ch. 13-64.

**Locks.** Residential buildings must have certain security locks on building entrances, unit doors and windows. Mun. Code Ch. 13-164.

**Refuse Containers.** The landlord of buildings with five or more residential units must provide refuse containers and service for the building and a refuse compactor for buildings that generate high volumes of waste. Mun. Code Ch. 7-28.

**Discrimination.** A person cannot discriminate with respect to the rental of any unit based on race, color, sex, age, religion, disability, national origin, ancestry, sexual orientation, marital status, parental status, military discharge status or source of income. Mun. Code Ch. 5-8.

A person also cannot discriminate in the sale or lease of a condominium unit to a person on the basis of race, religion, sex, sexual preference, marital status or national origin. Mun. Code Ch. 13-72 Section 040.

State statutes also exist that an investor must follow. For example, the Illinois Security Deposit Return Act governs security deposits received by a landlord of residential real property in Illinois containing five or more units. The Act prohibits a landlord from withholding the tenant's security deposit unless he has, within 30 days of the date that the tenant vacated the premises, furnished to the tenant, an itemized statement of the

damage allegedly caused to the premises and the estimated or actual cost for repairing or replacing each item. The landlord also must provide paid receipts to the tenant for the repair of the damage within a certain time. If the landlord fails to do so, the landlord must return the tenant's security deposit in full within 45 days of the date that the tenant vacated the property. If the landlord violates these requirements, the tenant can recover twice the amount of the security deposit due, court costs, and reasonable attorneys' fees.

Investors have a challenge to ensure that they are aware and compliant with all laws that govern their property. Small investors have a particularly difficult time because it is an expensive undertaking for the investor to ensure that he is in compliance with all of the applicable laws. However, the effort and expense that an investor incurs to ensure his compliance is often substantially cheaper than the effort and expense of a lawsuit resulting from the investor's noncompliance. Thus, an investor is well advised to work diligently to be in compliance.

## ***B. SELECT AND DEAL WITH TENANTS CAREFULLY.***

Tenants who are looking for a way to make a legal claim against their landlord are typically able to find one given that it is very difficult for a landlord to ensure that he is in full compliance with all applicable laws all of the time. Investors typically review financial and credit information from a prospective tenant to assess the tenant's ability to pay the investor rent. However, this information does not inform the investor of the probability that the tenant might file a claim against the investor. A tenant's legal claim could cost the investor substantially more money than the investor may lose from unpaid rent.

To minimize his exposure to tenant claims, an investor should attempt to assess the litigious nature of his prospective tenants before entering into a lease with them. Interviewing prior landlords could give the investor insight into whether the tenant is litigation prone. In addition, the investor should attempt to illicit information from the tenant about whether he had complaints about his previous landlord and dwelling unit. If the tenant's personality seems to be one that would lend itself to the tenant making legal claims against the investor, the investor should consider this carefully in deciding whether to rent to the tenant.

If a dispute arises during the tenancy between the investor and a residential tenant in particular, the investor should seek the advice of his attorney immediately. The attorney can assist the investor to ensure that the investor does not violate any laws in his dealings with the tenant relating to the dispute. In addition, the attorney may be able to assist the investor in reaching an amicable resolution of the dispute.

Once a residential tenant has contacted an attorney about a dispute with his landlord, it is often too late for the investor to avoid the burden and expense of litigation. The tenant's attorney will inform the tenant that tenants often can recover large penalties from their landlords for legal violations even if the tenant has not been damaged by the violation. The tenant's attorney also will likely inform the tenant that the tenant does not need to pay for the services of the attorney in pursuing a lawsuit against his landlord

because the tenant's attorneys' fees are recoverable from the landlord. Thus, an investor generally will save himself money in the long run if he retains his attorney to advise him with respect to a tenant dispute at the onset of the dispute rather than at a later time.

### *C. SECURE ENFORCEABLE RIGHTS AGAINST TENANTS.*

An investor should ensure that he has a comprehensive lease in force with his tenants that is specifically tailored to the tenancy. Often investors believe that they save money by using a standard form lease, but they usually spend more money in the long run as a result of disputes that arise with the tenants that would not have arisen if the disputed issues had been explicitly covered in the lease from the onset. The investor should ensure that the following subject matters are addressed in detail in each tenant's lease:

**Leased Premises.** The lease should identify specifically the premises that are leased by the tenant. If the tenant has rights with respect to other areas at the property such as storage lockers or parking areas, then the lease should clearly describe these rights. The landlord should prohibit the tenant from posting signs or placing other objects in the windows of the property without the prior written approval of the landlord. In commercial leases, the landlord should define the tenant's rights to display commercial signage at the premises. The landlord should require the signage to be approved in advance in writing by the landlord and should ensure that the signage will not interfere with the signage of other tenants at the premises.

**Lease Term.** The lease should state the lease term by clearly designating when the lease will start and when it will end. If the tenant has an option to renew, the terms of the option and the method by which the option is to be exercised should be stated clearly.

**Rent.** The lease should specifically state the amount and due dates of the tenant's rent. Late fees should be provided for the tenant's late payment of rent, subject to applicable law that may limit these fees. Rather than stating a fixed late fee, the late fee should increase depending on how late the tenant's payment is so that there is an incentive for the tenant to pay promptly even after he is late.

**Security.** The landlord should ensure that he has adequate security from the tenant to cover unpaid rent, damages caused by the tenant, and vacancy arising from the tenant's nonperformance of his lease. Especially for residential tenancies, it takes a landlord a considerable length of time to evict a tenant from a leased premises. In addition, the landlord may incur a substantial period of vacancy after the tenant vacates. The landlord should ensure that the amount of the security that he has from the tenant is sufficient to cover these amounts.

The best type of security for the landlord to hold is a cash security deposit from the tenant. Only by holding a cash security deposit is the landlord able to obtain relief from the tenant without instituting a lawsuit or other proceedings to recover from a tenant who defaults. If the tenant is an individual with few assets, the landlord should require a

person who has substantial assets to co-sign or to guarantee the lease. If the tenant is a company, the landlord also should obtain personal guarantees from the individual owners of the company. If the tenant is an out-of-state tenant, the landlord should obtain more security from the tenant because it will be more expensive for the landlord to collect a judgment against a tenant whose assets are out-of-state than whose assets are in-state.

**Repairs, Maintenance, and Replacements.** The obligations for repairs and maintenance give rise to a substantial number of the disputes among landlords and tenants. Therefore, the landlord should take particular care to ensure that the lease defines in detail the respective duties of the landlord and tenant for repairs, maintenance, and replacements at the property. The particular structures and areas that the landlord and the tenant are to repair, maintain and replace should be specifically identified. In addition, the procedures that constitute adequate repair, maintenance, and replacement should be stated. The landlord also should ensure that the lease states that the tenant has inspected the property and is accepting it in its present condition so that the tenant cannot immediately demand that the landlord do work on the property.

**Utilities.** The lease should allocate all charges for utilities and other services to either the landlord or the tenant. If the tenant does not occupy the entire premises, the lease should provide a clear method for allocating the cost of the utilities and other services to the tenant.

**Real Estate Taxes.** The lease should specify whether the landlord or the tenant is to pay the real estate taxes and any special taxes relating to the property. If the tenant does not occupy the entire premises and shares the real estate tax expense, the lease should provide a clear method for allocating the real estate taxes to the tenant.

If the tenant is to pay the real estate taxes, the landlord should require the tenant to make regular payments toward the tax bill as the taxes are incurred and provide a mechanism by which the tenant's payments will be reconciled with the actual tax amount when it is due. The landlord should not wait until the taxes are due to the county collector to collect the taxes from the tenant. Real estate taxes are due to the county collector in the year after they are assessed against the property. The landlord will be required to pay the tax bill even if the landlord has failed to collect for the taxes from his tenant. Thus, the landlord should collect the taxes when they are incurred to ensure that the landlord does not have to pay the bill with his own funds when it comes due.

**Permitted Use.** The lease should identify the activities for which the tenant will use the premises and should prohibit other uses by the tenant. Especially for residential leases, the landlord should expressly prohibit activities by the tenant that tend to give rise to liabilities for the landlord, such as under-aged or excessive drinking, drinking in locations of the premises that are particularly risky such as stairways and porches, and allowing more than a specified number of individuals to be present at the premises at one time. The lease also should limit the number of individuals who may work or live at the premises.

In addition, the lease should require the tenant to comply with all laws that are applicable to the premises and the tenant. Commercial leases should state specifically that the tenant must comply with the American Disabilities Act of 1990, 42 U.S.C. §12101 *et. seq.* and the Illinois Human Rights Act, 775 ILCS 5/1-101 *et. seq.*, in addition to all other applicable laws.

**Insurance.** The lease should require the tenant to maintain liability insurance to cover claims for personal injuries and property damage that occur at the premises and casualty insurance to cover damages to the premises and the tenant's contents from fire, theft, and other casualties. If the tenant serves alcohol at the premises, the tenant also should be required to maintain a policy covering dram shop liability. The lease should specify the insurance coverage limits that must be maintained, require the tenant to cause his insurance company to name the landlord as an additional insured on the tenant's insurance policies; and require that the insurance be maintained with a reputable insurance carrier.

**Access.** The lease should provide the landlord with rights of access upon notice to the tenant to comply with the landlord's repair, maintenance and replacement obligations pursuant to the lease and to inspect the premises to ensure that the tenant is complying with the lease. For residential leases, the landlord should ensure that the access rights stated in the lease do not violate applicable law.

**Assignments.** The lease should prohibit the tenant from assigning or subletting the premises to a third party without the prior written consent of the landlord.

**Termination.** The lease should provide the events upon which the landlord can terminate the lease. For example, the landlord should have the right to terminate if (1) the tenant has breached the lease; (2) the premises is damaged or destroyed by fire or other casualty such that it is untenable or unusable and the landlord elects not to repair the premises; (3) the tenant is in bankruptcy or makes an assignment for the benefit of the tenant's creditors; and (4) the premises is taken by condemnation or eminent domain. The lease should state that the termination of the lease is not the landlord's exclusive remedy against the tenant, and the lease should expressly preserve all other remedies available to the landlord.

**Alterations.** The lease should identify the alterations that the tenant is permitted or required to make to the premises and the alterations that the tenant is prohibited from making. The lease should protect the landlord from mechanics liens attaching to the property for work that the tenant has done on the property for which the tenant does not pay.

**Attorneys' fees.** The lease should allow the landlord to collect his attorneys' fees and costs against the tenant incurred to successfully enforce the landlord's lease rights. However, residential landlords should ensure that the inclusion of an attorneys' fees provision does not violate any applicable law.

**Waiver.** The lease should provide that the landlord does not waive any of his rights under the lease or otherwise by failing to enforce the landlord's rights against the tenant or by any other conduct. The lease should state that all waivers of the landlord's rights must be in writing to be valid.

**Applicable Law.** The lease should specify the state law that will govern the interpretation of the lease and the court in which disputes arising from the lease will be brought. The landlord may wish to include a provision requiring arbitration or mediation of disputes arising from the lease.

**Miscellaneous.** The lease should provide that (a) the lease provisions are severable in the event that a particular provision is held to be invalid or unenforceable; (b) notices

shall be given in a particular manner and to a stated person and address; (c) the lease shall not be construed against its drafter; (d) the lease terms are binding on the successors of the tenant; and (e) any individual who signs the lease on behalf of a tenant that is a legal entity warrants to the landlord that he is authorized to bind the tenant to the lease.

Two issues with respect to leases warrant additional attention by the landlord. First, a landlord generally will not be liable for personal injuries or property damages if the injuries and damages arose from the condition of any portion of the premises over which the landlord had no control or maintenance obligations. For example, if the lease provides that the tenant has complete control and the obligation to maintain the parking lot at the premises, then the landlord generally will not be liable for personal injuries resulting from a slip and fall in the parking lot. Thus, it is advantageous for the landlord to shift all control and maintenance obligations to the tenant and thereby shift the premises liability to the tenant as well. Even if the landlord must reduce the tenant's rent by the amount of the maintenance costs anticipated to be incurred by the tenant, the lease will be more advantageous to the landlord because the tenant will be liable for the related personal injury and property damage claims. Often the tenant is unaware that the premises liability has been shifted to him by the maintenance obligation, and therefore, the tenant does not demand a reduction in the rent as high as the tenant should.

Second, a landlord may attempt to have the tenant indemnify and hold the landlord harmless or to limited the landlord's liability from certain types of claims, damages, or occurrences. If the tenant agrees to these terms, they can be very advantageous to the landlord. However, the landlord should exercise caution in including limitations of liability clauses in a lease because laws may prohibit these provisions and penalize the landlord for including them in the lease. For example, the RLTO applicable to the rental of residential units in the City of Chicago prohibits an investor from including such provisions in the tenant's lease and enables the tenant to recover two months rent for attempting to enforce the provision.

Similarly, the Illinois Landlord and Tenant Act applicable to any lease of real property in Illinois provides that every provision exempting a landlord from liability for damages for injuries to person or property caused by or resulting from the landlord's negligence in the operation or maintenance of the property is void. However, the Act does not prevent a landlord from limiting his liability for property damages in a commercial lease.

765 ILCS §705/1.

## V. MAINTAIN ADEQUATE INSURANCE

One of the most effective ways for an investor to protect his assets is to maintain adequate property insurance. The investor should ensure that the insurance includes casualty insurance to cover losses to property caused by casualties and liability insurance to cover the investor's liability for personal injuries caused by the condition of the property and the investor's conduct.

In addition, the investor should ensure that proper coverage limits are maintained. If the property is insured for less than its fair market value, then the property will be deemed to be underinsured and the insurance company will not pay the full amount of a casualty loss. Likewise, if liability insurance is not maintained for the full amount of a claim that is made against the investor, then the insurance company will not pay the full amount of the liability. Investors should pay particular attention to whether the policy limits are based on each occurrence or each separate claim that is made. For example, if the investor carries liability insurance up to a million dollars for each occurrence, then the insurance company will only be liable to pay a million dollars in total for claims arising from the occurrence even if multiple people make claims against the investor arising from the same occurrence. If the investor carries liability insurance up to a million dollars on a claims-made basis, then the insurance company will be liable to pay a million dollars for each claim made against the investor even if the claims all arise from the same occurrence.

Finally, the investor should pay careful attention to the exclusions contained in his insurance policy. For example, standard insurance policies typically do not compensate the investor for rent that the investor loses from tenants if the property is uninhabitable because of a casualty. A standard homeowner's policy also typically excludes areas rented by the homeowner to tenants and the personal property of tenants that is located at the property. Standard insurance policies also do not include coverage for liability arising under the dram shop laws as a result of alcohol being served at the property.

In short, an investor should read his insurance policy very carefully to understand what the monetary limits of the coverage are and what types of items are excluded from the scope of the policy. The investor should ensure that the coverage includes all types of claims that are likely to arise relating to the property for the anticipated amount of the claims. Most importantly, an investor should never assume that maintaining insurance alone is sufficient to protect himself from all losses and liability that may arise from the property. The additional measures discussed in this book are important even if the investor carries insurance. This is because it is always possible that a loss or liability could arise that exceeds the insurance coverage limits, that is excluded from the scope of the insurance coverage, or for which an insurance claim is denied for some other reason.

## VI.

# PROTECT PERSONAL ASSETS

An investor can protect his personal assets from being used to satisfy the claims and debts that arise from his property by establishing a separate legal entity to hold the property. Generally, a limited liability company is the most advantageous entity that an investor can establish to hold property because it offers the investor both limited personal liability and certain tax advantages that are unavailable for other entities types.

There are two types of limited liability companies. The first type is a standard limited liability company and the second type is a series limited liability company. The main difference between the two types is that the assets of the company are held as one group within a standard limited liability company whereas the assets of the company are divided into separate groups, called series, within a series limited liability company. For example, if a series LLC holds multiple properties, then each property will be held by a separate series within the series LLC. The filing fees to maintain a series LLC to hold multiple properties are cheaper than to maintain a separate LLC to hold each property.

### *A. OBTAIN LLC LIMITED LIABILITY*

A limited liability company offers an investor limited personal liability provided that certain requirements are satisfied. 805 ILCS §180/10-5(a). This means that only the assets of the limited liability company will be available to satisfy the claims and debts that arise from the property and not the personal assets of the investor who owns the limited liability company.

A series limited liability company offers additional liability protection because only the assets of a particular series, and not the assets of other series, will be available to satisfy

the claims and debts that arise from the assets of a particular series. Therefore, if an investor owns multiple properties, the investor can put each property in a separate series of the limited liability company. If certain requirements are satisfied, then only that property will be available as an asset to satisfy the claims and debts that arise from the property. The properties that are held in other series within the limited liability company will not be available to satisfy the claims and debts that arise from the property.

In contrast, other mechanisms by which investors may hold property, such as in a land trust, in a general partnership, or in the investor's personal name, do not afford the investor limited personal liability. If the investor holds property by these mechanisms, the investor's personal assets will be subject to the debts and claims that arise from the property. Therefore, holding property by these mechanisms subjects the investor to considerably more risk than holding property in an entity that affords the investor limited personal liability.

## ***B. AVOID THE LIMITATIONS ON LIMITED LIABILITY***

Entities that offer their owners limited liability, such as limited liability companies, do not afford their owners absolute limited liability protection. If the owners of an entity do not follow certain rules, then the corporate veil will be pierced and the personal assets of the entity's owners will be subjected to the claims and debts of the entity. The owners of a limited liability company will be personally liable for the claims and debts of the limited liability company if (1) there is a unity of interest and ownership such that the separate personalities of the LLC and the individual no longer exist; and (2) the continued adherence to the fiction of a separate corporate existence would sanction a fraud or promote injustice. *In re Kreisler*, B.R. 331 B.R. 364, 379 (N.D. Ill. 2005).

If an individual commingles his funds or assets with those of the LLC or treats the LLC's assets as his own, this suggests that there is a unity of interest and ownership between the LLC and the individual. In making the second determination, courts generally consider the following factors: (1) inadequate capitalization; (2) the failure to issue membership interests; (3) the non-payment of distributions; (4) the insolvency of the entity; (5) the non-functioning of the managers or officers; (6) the absence of company records; (7) commingling of funds; (8) diversion of assets from the LLC by or to a member; (9) failure to maintain arm's length relationships amount related entities; and (7) whether the LLC is a façade for the operation of the dominant shareholder. *Jacobson v. Buffalo Rock Shooters Supply, Inc.* 278 Ill.App.3d 1084, 1088, 664 N.E.2d 328, 331, 215 Ill. Dec. 931, 934 (3<sup>rd</sup> Dist. 1996).

However, the Illinois LLC Act expressly states that the failure of an LLC to observe company formalities or requirements for the exercise of company powers or management does not result in personal liability. 805 ILCS §180/10-10(c). This provision in the Act is unique to limited liability companies and suggests that it will be more difficult for a creditor to pierce the veil of a limited liability company than to

pierce the veil of another type of limited liability entity. This is because the creditor will not be able to rely on the LLC's failure to observe company formalities as a justification for piercing the corporate veil of a limited liability company, but will be able to rely on this failure in piercing the corporate veil of another type of limited liability entity.

For series limited liability companies, the Illinois LLC Act sets forth specific conditions that must be satisfied in order for the assets of the series LLC's owners and the assets of other series to be protected from liability. 805 ILCS §180/37-40(b). These conditions are the following:

The LLC's operating agreement must create series and explicitly provide for limited liability for the series;

- 1) Separate and distinct records must be maintained for each series;
- 2) Each series' assets must be held (directly or indirectly, including through a nominee or otherwise) separately;
- 3) Each series' assets must be accounted for separately;
- 4) Notice of the limited liability must be contained in the LLC's articles of organization; and
- 5) The series must file a certificate of designation with the Secretary of State.

*Id.*

The LLC Act also specifies circumstances that will not cause a series LLC to lose its additional limited liability protection. 805 ILCS §180/37-40(b). A series LLC does not lose its limited liability if the LLC and any of its series consolidate their operations as a single taxpayer or are treated as a single business for purposes of qualifying to do business in Illinois or another state. *Id.* In addition, the LLC Act states that the LLC and any of its series may work cooperatively or contract jointly without losing their limited liability protection. *Id.*

## *C. PROTECT THE LLC OWNERSHIP INTEREST FROM CLAIMS*

Even if an investor's personal assets are protected against the debts and claims arising from the property because the property is held in an LLC or other limited liability entity, the investor's ownership interest in the entity will be subjected to debts and claims that arise from the investor's personal dealings. For example, if the investor is liable for personal injuries that the investor caused to others in an automobile accident, then the investor's ownership interests in his LLC or other limited liability entity will be subject to the claims of the injured person. To maximize his asset protection, the investor should minimize the operations that the investor carries out in his individual capacity. An investor's assets will always be subject to claims arising from the investor's own negligent or intentional conduct. However, the investor can reduce his exposure to other claims by carrying out all of the investor's business operations through a limited liability entity rather than in his personal capacity. For example, the investor's ownership interest in an LLC or other limited liability entity will not be subject to negligence claims arising from the conduct of other individuals, contract claims, or statutory claims that arise from the investor's other business operations if the investor carries out these operations through a limited liability entity rather than in the investor's personal capacity.



THE TUCKER FIRM

# CREATE A REAL ESTATE LLC

Holding your real estate in a separate legal entity such as an LLC is essential to prevent creditors from reaching your personal assets and to take advantage of certain tax benefits.

By using an attorney to create your real estate LLC, you ensure that your LLC is structured properly and advantageously.

THE TUCKER FIRM provides these legal services to create an LLC for CCIA members for a special, fixed fee of \$1,500:

- Consults with you to determine an appropriate entity structure
- Drafts a subscription agreement for your investment in your company
- Files setup documents with the Secretary of State
- Drafts an operating agreement to govern your company
- Drafts the company minutes for the start of your company
- Provides a voting list and share transfer record
- Obtains your federal tax number
- Registers your company with the Illinois Department of Revenue

Additional fees apply to LLCs with multiple owners, to LLCs to hold multiple properties, and for the transfer of currently-owned real estate to the LLC. Government LLC filing fees of \$500 also apply.

THIS SPECIAL PRICING IS AVAILABLE UNTIL **JUNE 30, 2006**

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