ILLINOIS STATE BAR ASSOCIATION

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Real Property

The newsletter of the Illinois State Bar Association's Section on Real Estate Law

A Note From the Outgoing Chair

BY EMILY R. VIVIAN

It has been my pleasure to serve as the chair of the Real Estate Law Section Council this past year. If I am not mistaken, it was the first all-female-led Real Estate Law Section Council!

Hailing from the small town of Dixon, I find it appropriate to quote the late President Ronald Reagan, "The greatest leader is not necessarily the one who does the greatest things. He is the one that gets the people to do the greatest things." I am certainly not suggesting that I was a great leader. Rather, any credit that I am given for leading this Section Council over the past year should be spread among all my fellow Councilmen and women. As I indicated to our incoming chair, Sharon Eiseman, serving in the role as chair of the Real Estate Law Section Council

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The NAR Settlement: Will Buyers Really Be Forced to Pay Their Agent?

BY PHILIP J. VACCO

The recent settlement reached with the National Association of Realtors (NAR) over alleged antitrust practices has some individuals heralding the end of high sales commissions. But, a closer examination of the settlement terms leaves this author to conclude that the death of the seller-based commission model may be a bit exaggerated.

The antitrust lawsuit filed against the NAR stemmed from their adopted business model that incorporated a commission-sharing policy among its member brokers. In particular, it was argued that forcing sellers to agree to pay the buyer's agent's fees at the time that they listed their property allowed the NAR and its members to reduce competition and artificially inflate real estate commissions. A key element of this argument was the fact that under the connectMLS®, the private

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A Note From the Outgoing Chair

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is a pleasure because of the dedicated, hardworking members that comprise this Section Council.

I want to thank each and every member for his or her service to the Section Council. Special thanks to Mike Maslanka and Nikki Sonntag, who continue to publish a newsletter every month, going above and beyond the required number of publications. Paul Peterson worked tirelessly to analyze and opine on proposed legislation (and good golly, there was a plethora of bills related to mobile homes). Laura Lundsgaard and her CLE team held several CLE programs, including programs on commercial real estate issues, due diligence issues, AI, and blockchain, while Sharon Eiseman, Judge Perkins, and Leslie Hairston continued to present Webinars.

In addition, Tiffany Thompson and Joseph Rogul accepted the monumental task of advising us all on the new Notary Public Act and the corresponding regulations issued by the Secretary of State. Jenna Kearns and Mario Sullivan graciously updated the ISBA Consumer Legal Guide on Landlord-Tenant Law, which is now available to the public on the ISBA Website.

Last, but not least, I want to thank Sharon Eiseman for serving as vice chair and Cheryl Morrison for preparing the minutes for every meeting, which is not an easy task with such vociferous members.

Thank you all for your support and commitment over the last year. It is truly humbling to be surrounded by all of you as we critically analyze proposed legislation and recent cases. I truly feel a sense of pride in our profession when I am among you. I wish the best to Sharon, Cheryl, and Tiffany in the upcoming year! I know they will do great things.■

The NAR Settlement: Will Buyers Really Be Forced to Pay Their Agent?

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database maintained by the NAR and its membership, it was NAR's written policy to require listing agents to reflect what was being offered as a cooperating commission when they listed a property for sale. (Reflecting no commission was NOT permitted and resulted in the listing being placed on "hold" and an automatic fine being imposed against the listing agent.) To state it differently, the argument was made that the buyer's agent, who ultimately is working for the buyer, should be paid by the buyer and not the seller. Thus, by separating the obligation to pay the brokers' commissions between the parties, it was argued that it would increase competition and ultimately result in reducing the commissions paid by sellers to sell their property.

Following a two-week trial, a federal jury did in fact find the NAR guilty of conspiring to artificially inflate sales commissions on home sales and ordered it to pay an eye popping $1.78 billion in damages. However, since the verdict was reached under the federal antitrust law, the court had, within its discretion, the power to triple the damage award to more than $5.3 billion dollars. This, ultimately, has led to the NAR agreement to settle the matter.

Settlement Terms

Without admitting any wrongdoing, the NAR has agreed to pay $418 million in damages, and implement a series of rule changes for its members. Of particular note was NAR's agreement to eliminate the requirement that the seller's agent had to offer a portion of the sales commission as compensation to the buyer's broker. This change, which is intended to take effect on August 17th of this year, will result in a new rule being implemented that will prohibit listing agents from offering any compensation to buyer's agents through the MLS. In addition to this seismic change, the

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NAR will now require all buyer's agents to enter into a written agency agreement with their clients clearly outlining how they will be compensated for their services. It is this acknowledgment that the seller will no longer be required to offer a buyer's agent compensation that has proponents of the suit announcing that commissions should fall dramatically but, in reality, once the dust of the initial shake-up settles, it may simply be business as usual.

It should be noted that asking buyers to compensate their agents for their services in Illinois is not a new idea. Under the theory of agency representation, the real estate broker can wear one of several hats when dealing with the public. The broker can be an agent of the seller (typically the listing agent) who has a legal duty to represent the best interests of the seller. A buyer's agent has a legal duty to represent the best interests of the buyer. The broker can act as a "dual" agent, in which the broker represents both the buyer and seller, as long as they disclose certain limitations. Basically, the agent agrees to treat each party honestly, and act to facilitate the transaction. Or, the agent may agree to provide only ministerial services, in which case they are deemed not to be representing either party. As such, for the last four decades, the Illinois Association of Realtors® has encouraged its members, when working with buyers, to use an "Exclusive Buyer Representation/Exclusive Right to Purchase Contract" which outlines the duties the agent has when representing the buyer but, more importantly, in writing reflecting how the buyer was to pay the agent.[1] However, this form to date has rarely been put to use, considering the long-standing custom of requiring the seller to pay a cooperating commission. So, now that the buyer's agent will be forced to seek payment for their services from their clients, the question becomes how will the buyer respond, and will this result in any significant savings for the seller?

Since the inception of the real estate broker, commissions on the sales of homes have traditionally been based off the sales price and paid by the seller, so buyers have been conditioned to expect that any sales commission due the brokers from their purchase, will, in fact, be paid out of the seller's proceeds of the sale. Typically, the seller would negotiate with the listing agency the amount of the commission to be paid, and the listing agent would then offer, through the MLS, a portion of that commission to the buyer's agent if they produced a buyer. However, the settlement barring the broker from offering a cooperating commission on the MLS and actually shifting the burden to the buyer to pay for these services, has the profession on edge with some analysts predicting that there will be an exodus of brokers, and still others predicting that buyers will simply refuse to pay for a broker and opt to go through the process of purchasing a home on their own. But, I believe this outcome is far from certain since it fails to take into consideration a number of factors which, for now, make it unlikely that the buyer will be left to pay their broker's commission.

Today, many brokers have expressed concerns over how we can expect the buyer to pay for their services when they are already struggling to manage the expenses associated with purchasing real estate. I mentioned above, today's buyer has been led to believe that the sales commission will be paid by the seller if for no other reason than that is how it always has been. So, good luck in convincing them that they need to pay a broker thousands of dollars because they showed them a home and assisted them in making an offer. Other factors such as the continued shortage of real estate inventory, which has dramatically driven up the price of homes, higher interest rates brought on by federal policy seeking to reduce inflation, increasing real estate taxes, and the general high costs associated with owning and maintaining a home, it should come as no surprise that today's buyer has little interest in, nor the ability to pay for the services of their broker.

Second, the NAR has made it clear that it is NOT unlawful under the settlement for the seller to continue to offer to pay the buyer's agent as long as that obligation has been freely negotiated. The problem then is not whether the seller can pay the buyer's agent, but that the offer of compensation cannot be automatically imposed on the seller. To this end, while agreeing to prohibit the use of the MLS to make offers of buyer's agent compensation, the NAR has acknowledged that there are other means for the buyer's agent to be paid by pursuing "negotiated" off-MLS forms of compensation. According to the NAR this could take multiple forms including, but not limited to:

Negotiate a fixed-fee commission to be paid directly by the consumer.

This option, which probably will not be the go-to choice for brokers, would entail the broker negotiating a flat or fixed-fee commission fee with the buyer as part of their exclusive agency agreement. This will enable the buyer to have greater control over what they pay the broker by placing a "cap" on the compensation that the buyer would be obligated to pay. Here the broker will be gambling that the seller may, through the negotiation process, be willing to offer additional compensation.

Negotiate "concessions" from the seller.

Sellers, in an attempt to get their property marketed to a greater pool of potential buyers, may offer financial incentives in the form of "closing cost credits" which can then be used to compensate the buyer's agent. The good news is that both Fannie May and Freddie Mac have issued opinions that they will not consider seller concessions to the buyer for the payment of the buyer's agency fee as applying to the 3 percent cap they use for closing cost credits. Thus, on a $500,000 home, where the buyer's agent is seeking a 2.5 percent commission, or $12,500, the buyer can receive this credit from the seller and still negotiate for a larger closing cost credit for financial assistance. However, basic economic reality reminds us that the seller will most likely adjust the asking price to take into account any such credit. (On a related note, I have been informed that the VA intends to remove from its guideline, their rule that prohibits the buyer from paying any portion of the broker's commission.)

Seek a portion of the listing broker's compensation.

There is nothing in the settlement agreement that would prohibit the buyer's agent from reaching out to the listing agent in an attempt to negotiate receiving a portion of the commission being paid to the listing agent from the seller. The key is that any

agreement has to be reached during contract negotiations and the broker most likely would have to obtain the consent of the client to do so since the broker's interests and the buyers are not necessarily the same.

This means that we can anticipate seeing contracts where compensation to the buyer's agent will be somehow worked into the sales agreement itself, whether by means of some form of seller provided credit or direct payment to the buyer's agent. The bottom line is that the seller will still be allowed to pay all or a portion of the cooperating broker's commission, so long as it is pursued "off-MLS" through negotiations and consultations with real estate professionals. So, while the NAR settlement may open the door for sellers to negotiate a more favorable sales commission fee with their agent, they will still be pressured to offer additional financial concessions to the buyer to off-set the buyer's financial obligations.

"You say tomato, I say tomahto." The bottom line is while it may no longer be called a cooperating commission, rest assured, sellers will continue to be asked to provide funds in one form or another that can then be used to pay the buyer's agent; the question is will they? While I would expect to see some give and take as to how much the seller or the seller's agent may be willing to contribute to the buyer's agent, this will depend upon the condition of the market. With the strong seller's market that we have today, I would expect more buyers may have to come up with a creative way to figure out how to pay their agent. This may entail buyer's brokers offering a flexible fee structure, where buyers can select the level of service they wish to obtain negotiating for limited services. For example, the buyer may pay a limited fee to have the agent arrange a showing or a higher fee to facilitate negotiations on their behalf. In effect, there will be a "menu" of services and prices that the buyers may choose from. This is where I see potential savings for the public. But, I also envision buyers who may reach out to the legal profession to have us draft and submit offers on their behalf and totally eliminate the involvement of the broker.

Only time will tell whether or not sellers will agree to continue to compensate the buyer's agent or if they will insist that the buyer pay their own way. However, keeping in mind that at some point in time the listing agent will be in the position of representing a buyer, I believe that there will be a push within the brokerage community to continue to encourage sellers to pay the buyer's broker's fee as part of their offer, and it will be pretty much business as usual.■

1. Section 8: Compensation: Broker and Buyer expect that the Broker's commission will be paid by the seller or seller's Broker for acting as a cooperating agent. However, if Broker is not compensated by the seller or the seller's broker, or if the amount of compensation paid by the seller or seller's broker is not at least _____ percent of the purchase price, then Buyer agrees to pay Broker the difference between _____ percent of the purchase price and what seller or seller's broker actually paid."

Redlining, AI, and Economics: A Look Into the Illinois Community Reinvestment Act

BY DONALD HYUN KIOLBASSA & EMILY HOLMES

There are three books which prepare one for life as a lawyer. Sun Tzu's *Art of War* teaches one strategy. Niccolo Machiavelli's *The Prince* teaches one politics. Adam Smith's *The Wealth of Nations* teaches the art of economics.

Adam Smith published *The Wealth of Nations* in 1776. The Scottish economist illustrated on how to build a nation's wealth. There have been countless interpretations on the book. One interpretation is that the classic book provides the "Secret Formula" in building wealth.

Essentially, the book teaches us the three ways to make money are salary, profit, and rent. Salary is working for someone (e.g., a W-2 employee). Profit is owning a business (e.g., a 1099-MISC). Rent is owning appreciable property (e.g., Sch E on the 1040). A balanced wealth-building strategy should include a relative proportion of each.

It should be noted that profit and rent are especially critical as they are the prongs that build generational wealth. Profit and rent have "equity," which can be passed on to the next generation. However, some that argue they struggle with starting a business or acquiring appreciable property due to financing discrimination.

The Illinois Community Reinvestment Act attempts to solve the problem of providing available financing for owning appreciable property to historically discriminated groups.

Historically, lending institutions once practiced a technique called "redlining." Redlining is a color-coded classification system implemented by the Federal Housing Administration that determined the value of housing based on the racial demographics of a neighborhood.

If your neighborhood was given a low grade, then banks would tend not to lend in the community. It should be noted that real estate prices are driven by the ability to lend on the property (i.e. if financing is not available, it drives down the price).

Many predominantly African American

communities were arbitrarily given low grades. The lack of lending decreased the value of homes, which impacted families' ability to build, store, and pass on wealth.

Policy impacts behavior.

In 1977, President Jimmy Carter attempted to destroy discrimination in the mortgage industry with the Community Reinvestment Act. Although this was a great macroeconomic first step, it did not impact all communities on a microeconomic level.

Thus, in 2021, the Illinois legislature formally adopted the Illinois Community Reinvestment Act (the "Act"). The Act puts an affirmative obligation on covered financial institutions to work with people of all communities.

Specifically, (205 ILCS 735/35-10(a)) states, *"Each covered financial institution shall have a continuing and affirmative obligation to meet the financial services needs of the communities in which its offices, branches, and other facilities are maintained…"*

The statute 205 ILCS 735/35-15 gives the Illinois Department of Financial and Professional Regulation ("IDFPR") the ability to examine the covered financial institutions to give them a rating. According to 205 ILCS 735/35-15(c), the rating shall be one of the following:

- outstanding,
- satisfactory,
- needs to improve, or
- substantial noncompliance.

The IDFPR is the authority to enforce the Act. Namely, the statute 205 ILCS 735/35-20 allows the IDFPR to take this rating into account when banks apply for licensing with the State of Illinois.

This Act is good for all of us. Discrimination against anyone is discrimination against us all, especially when it comes to something as important as building personal generational wealth.

History shows that it is just a matter of time before it comes for you. Redlining in lending might be gone, but there are new challenges we face as a society. Artificial intelligence is coming and it is real and is coming for a job near you.

Analogous to redlining, artificial intelligence will identify entire segments of the economy to discriminate against.

The Milton Friedman Doctrine holds that the purpose of a company is to maximize the profits for shareholders. Human labor is an "input cost" to business. Under The Milton Friedman Doctrine, the goal of a company is to increase profit for the shareholders. One way to do that is by cutting expenses, including labor costs. Human labor may become waste in future companies.

If policy is not put into place today to impact behavior of companies, they may take the Milton Friedman Doctrine and discriminate/eliminate us all using technology for profit.

Policy impacts behavior. This policy under 205 ILCS 735/35-15 is good for all of us. It acknowledges the sins of the past and tries to help us all for the future.

Let us rise together and promote each other with the blueprint laid out in Adam Smith's *The Wealth of Nations*. We can all help each other to create our own respective and relative forms of salary, profit, and rents.

If we do not get in front of this, artificial intelligence may just redline YOU one day.■

Top 10 Issues a Landlord Should Consider Before Leasing to a Cannabis Tenant

BY NICKY SONNTAG

This article addresses the top ten issues that a landlord should consider before leasing to a cannabis tenant.

Issue 1: Federal Law Prohibition

The Controlled Substances Act prohibits knowingly opening, leasing, renting, using, or maintaining any place to permanently or temporarily manufacture, distribute, or use any controlled substance, including cannabis. 21 U.S.C. § 856(a)(1). While the Department of Justice has currently relaxed prosecution efforts, landlords still are at risk for the potential loss of the landlord's property, rent, and other assets because of forfeiture by the federal government until cannabis is legalized at the federal level.

Issue 2: Bank Issues and the Risk of an Existing Financing Default

The Bank Secrecy Act makes it a crime for a bank to knowingly engage in monetary transactions that involve the proceeds of illegal business activities.(31 U.S.C. §§ 5311 to 5314; §§ 5316 to 5332; 12 U.S.C. § 1829(b) and §§ 1951-1959; and 18 U.S.C. §§ 1956 and 1960. The Bank Secrecy Act was enacted to address money laundering and terrorist financing issues. Because cannabis remains illegal under federal law, financial institutions may be reluctant to provide basic services to property owners receiving rent and other payments from cannabis tenants because of concerns with violating the Bank Secrecy Act.

Illinois has enacted a statute exempting a financial institution from prosecution under Illinois criminal law if the financial institution provides customary services to a cannabis business. 410 ILCS 705/55-65. However, this protects Illinois banks only under Illinois law but not under federal law.

The landlord should verify with its bank to determine what the bank's current policies are, including whether its bank accepts rent payments from cannabis businesses. If the landlord's bank does not accept rent payments from cannabis businesses, the landlord needs to evaluate how the landlord is planning to receive rent payments from the cannabis tenant.

Leasing space to a cannabis tenant may also impact the landlord's ability to obtain financing or violate the terms of its existing financing on the property. Lenders can be concerned about the risks involved in securing collateral for a loan that involves a cannabis business. A landlord may also have trouble refinancing its existing loan on the property.

Leasing to a cannabis tenant can violate the terms of the landlord's existing financing on the property. Commercial loans typically include provisions requiring the borrower to comply with applicable laws and that prohibit the property from being used for any illegal activity. Because cannabis is currently illegal under federal law, a landlord risks defaulting on its real estate loan by leasing to a cannabis tenant. The landlord's counsel should carefully review its loan documents before the landlord leases to a cannabis tenant and should seek the lender's written approval and amendment to the loan documents, if necessary, before entering into negotiations with a cannabis tenant.

Issue 3: Insurance

Insurance companies may be reluctant to provide property and liability insurance coverage to landlords leasing property to a cannabis tenant. The landlord should notify its existing insurance carrier before leasing to a cannabis tenant to ensure that leasing to a cannabis tenant operating at the property does not violate its existing insurance policies. Failing to do this may result in insurance coverage being canceled or a claim being denied. A landlord may want to consider engaging an insurance broker that specializes in insuring cannabis tenants to help evaluate and mitigate the insurance risks the landlord faces when leasing to a cannabis tenant.

Landlords should a include provision in the lease requiring the cannabis tenant to pay for any increase in the landlord's insurance costs resulting from the cannabis operations being conducted by the tenant. The landlord should also include in its lease a termination provision if the cannabis tenant cannot obtain or retain the required insurance coverage.

Issue 4: Financial Risk

The landlord takes on substantial risks leasing to a dispensary tenant because of the sale of cannabis being illegal under federal law including the risk of forfeiture. The landlord may want to require, in addition to a large cash security deposit, a guaranty from the individual owners of the cannabis facility that have substantial net worth. The landlord should consider having some combination of a large cash security deposit, a guarantor with significant financial resources, and a letter of credit (if a bank is willing to issue a letter of credit) from the cannabis tenant.

Issue 5: Zoning and Land Use Issues

Local municipalities may restrict the operation of a cannabis business. Special permits or variances may be required under the local zoning code that can be costly and time consuming. The State of Illinois and municipal law may require mandatory buffer zones that restrict the location of a cannabis business which may preclude the premises as a location for the cannabis operation. Securing zoning board approvals can be time consuming.

Illinois law provides that a unit of local government can enact reasonable zoning ordinances or resolutions regulating cannabis business establishments. 410 ILCS 705/55-25. The voters of any precinct within a municipality with a population of more than 500,000 may petition their local alderperson to introduce an ordinance establishing the precinct as a restricted zone. 410 ILCS 705/55-28.

Reciprocal easement agreements or other restrictive covenants recorded against the landlord's property may specifically prevent the operation of a business for the sale of drug-related paraphernalia or the operation of a business that is considered a nuisance or illegal. The landlord may have to negotiate amendments to these private land use agreements to permit the operation of the cannabis business on the property.

Issue 6: Title Insurance Issues

Although Illinois law has decriminalized certain cannabis activities, title companies may refuse to insure title to Illinois real estate associated with a cannabis use. A title company may decline to issue a title policy, not only to the tenant operating a dispensary that is legal under Illinois and local laws, but to the landlord and the landlord's lender. Title companies may also refuse to close or administer an escrow for a transaction involving real estate associated with a cannabis use and may decline to handle funds, including loan proceeds, or to record any of the transaction documents. If title insurance is needed, counsel should discuss the possibility of title insurance and escrow with their title company to determine whether any circumstances exist that allow the title company to provide title insurance or closing services.

Issue 7: Environmental Concerns

Waste generated by cannabis tenants, especially by cannabis growers and cultivators, differs from other kinds of industrial or commercial by-products. This waste may contain substances that are regulated under federal and Illinois law, including active pharmaceutical ingredients, such as cannabidiol, which may be considered hazardous. The improper storage and disposal of cannabis wastes can expose a landlord to significant liability.

Cannabis must be disposed of in compliance with applicable Illinois, federal, and local laws and regulations. Landlords should consult with environmental counsel to ensure that the cannabis tenant complies with all applicable laws and regulations. Depending on the type of cannabis business being operated at the property, the landlord should also consider obtaining (or requiring the cannabis tenant to obtain) pollution/environmental insurance coverage to mitigate the environmental risks associated with the cannabis tenant's operation.

Issue 8: Lease Commencement Dates and Term

Applicants for retail licenses usually must prove that they have the right to occupy the proposed retail site. This means that the proposed licensee will often sign the lease before the license is issued. The tenant may negotiate for the right to terminate the lease if the tenant cannot obtain all the required licenses and approvals to operate its business at the premises or if the licenses or approvals expire or are cancelled. It may take several months for a tenant to obtain a license and other necessary approvals. The landlord may not be receiving rent during this period and risks that the tenant may not be issued the license and must cancel the lease.

Landlords should consider requiring that the tenant pay a nonrefundable, one-time payment at lease execution to cover rent for the anticipated time period that the tenant needs to obtain its license to operate instead of having rent payments commence only once the business is operating. The landlord should also have the right to terminate the lease if the tenant does not receive all the required governmental approvals before an agreed outside date.

Issue 9: Security

Because cannabis dispensaries often operate with customers purchasing their products with cash and because of the value of the product itself, these locations can be a target for criminal activity. Enhanced safety measures are required for the property including security guards, commercial locks, cameras, and secured areas in compliance with Illinois requirements and laws.

The lease should expressly state that the tenant is responsible for providing security at the premises and for all costs related to the tenant's security personnel and systems. The tenant should also indemnify the landlord against any costs or claims resulting from criminal activities at the premises or the property and failure of the security systems and personnel.

Issue 10: Illegality Defense

Because cannabis is federally illegal, the tenant may assert a defense that its obligations under the lease are unenforceable. The tenant may also try to use this argument to void all or part of a lease. Illinois law provides that contracts related to the operation of a lawful cannabis business are enforceable even though the sale of cannabis is prohibited by federal law. This also applies to parties that allow the property to be used by a cannabis business establishment. 410 ILCS 705/55-75. The landlord should require the tenant to expressly waive any defense the tenant may have regarding the federal illegality of the tenant's use.■