

Second District provides recapture rights not subject to foreclosure

BY MICHAEL J. SMORON

In *FRS, Development Company, Inc. v. American Community Bank and Trust*, 2016 IL App (2d) 150157 (2016), the Second District Appellate Court recently determined that recapture fees due to a developer are not an interest in real estate, but rather, personal property not subject to foreclosure. The decision clarifies the nature of recapture rights and has implications for municipal counsel when dealing with recapture issues.

The Convolution Background

The Court was presented with the aftermath of a foreclosure proceeding, a deed in lieu of foreclosure, and the former property owner/developer seeking to obtain an agreement for recapture fees for road improvements in the Village of Huntley (the "Village"). FRS, Development Company ("FRS") and the Village entered into a facilities expansion agreement (the "FEA") which obligated FRS to construct roadway and intersection improvements in connection with a proposed subdivision. Under such agreement, FRS would be allowed to recapture a portion of the costs it expended in constructing those improvements which the Village would collect from the owners of certain benefitted properties through a "road improvement recapture agreement." The recapture agreement designated two parcels, the "40-acre parcel" and the "Garlieb-Hardy parcel" owned by FRS and F.G.M. Development ("FGM"), respectively, as benefitted properties whose owners would be charged fees for the use of the improvements. Both FRS and FGM were under common ownership. The Village would collect the recapture fees and remit them to FRS. FRS then acquired title to a parcel known as "Talamore" and conveyed same to Huntley Venture LLC along with the recapture rights. In turn, Huntley Venture LLC constructed the roadway

and intersection improvements. Because Huntley Venture needed additional land for the improvements, it acquired two strips of property from the 40-acre and Garlieb-Hardy parcels. As part of the purchase, Huntley Venture permanently waived the recapture rights against the 40-acre parcel and limited its recapture rights against the Garlieb-Hardy parcel to \$358,220 and a memorandum of this agreement was recorded. A dispute arose among Huntley Venture, FRS and FGM resulting in a settlement agreement by which Huntley Venture rescinded its waiver of the recapture rights on the 40-acre parcel and its limitation as to the Garlieb-Hardy parcel and assigned such recapture rights to FRS and FGM which was evidenced by a recorded assignment.

The Consent Foreclosure

Subsequently, in 2009, American Community Bank and Trust (the "Bank") sought to foreclose on the 40-acre and Garlieb-Hardy parcels. The foreclosure culminated in a settlement and consent foreclosure by which the Bank agreed to release its security interest in "all other chattel paper, accounts and general intangibles of FRS (including but not limited to all rights under the Settlement Agreement by and between FRS, FGM and Huntley Venture)." In turn, the attorney for FRS and FGM requested that the Bank release its security interest in the roadway and intersection recapture rights so as to enable them to be assigned to still another party, Nelson's-Florida LLC, before title to the 40-acre and Garlieb-Hardy parcels was conveyed to the Bank in the foreclosure process.

As part of the settlement and mutual release, FRS and FGM consented to the entry of judgment of foreclosure except as to "intangible collateral." The Bank also signed a "Release of Security Interest"

specifically releasing its interests in the roadway and intersection recapture rights. FRS and FGM delivered to the Bank quit claim deeds for the 40-acre and Garlieb-Hardy parcels which were made expressly subject to the roadway and intersection recapture rights. Subsequently, Nelson's-Florida assigned the roadway and intersection recapture rights back to FRS.

FRS' Request for a Recapture Ordinance

FRS requested that the Village fulfill the terms of the FEA and adopt a recapture ordinance. The Bank was advised of same and represented to the Village that FRS did not own the recapture rights as they had been foreclosed. In turn, FRS sued the Village for breach of the FEA and the Bank for tortious interference with a contract. The Bank brought a declaratory judgment maintaining that the recapture rights had been foreclosed. During the litigation, the Village passed a recapture ordinance and FRS voluntarily dismissed its suit only against the Village. The Bank raised, among myriad other items, two issues: (1) whether Huntley Venture's waiver of the recapture rights prevented it from assigning those rights back to FRS; and (2) if Huntley Venture's recapture rights assigned to FRS were foreclosed.

Alleged Waiver of Recapture Rights

The Bank maintained that Huntley Venture's waiver of the recapture rights prevented it from assigning the recapture rights back to FRS pursuant to its settlement agreement. The Court framed the issue as to whether the parties to a contract are free to modify same so long as the modification does not violate the law or public policy. Pursuant to the settlement agreement, FRS, FGM and Huntley Venture agreed to rescind the waiver and

the limitation on the recapture rights was embodied in the right of way purchase and sale agreement. While the Bank maintained that Huntley Venture "permanently" waived the recapture rights and recorded the document, thus, memorializing that waiver, the Bank had no authority for the proposition that this arrangement could not be modified among those parties. The Court concluded that the settlement agreement modified the previous right of way purchase and sale agreement and effectively assigned the recapture rights to FRS.

Whether Recapture Rights are Subject to Foreclosure

The Bank argued that where the owner of real property also owns recapture rights, such recapture rights could be mortgaged, and upon foreclosure, such rights are part of such foreclosure.

The first part of the Court's analysis focused on the agreement between the Bank and FRS. It looked to the release language agreed to by the Bank that included "all rights of FRS . . . to recover roadway and intersection recapture payments and all other rights" under the settlement agreement of February 9, 2006 by and among FRS, FGM and Huntley Venture. Nowhere did the Bank and FRS make the distinction between "general intangibles" and recapture rights in relation to the Garlieb-Hardy and 40-acre parcels as the Bank maintained. The Court observed that the distinction seemed to be an afterthought because the Bank accepted the quit claim deeds to those parcels, specifically reserving the recapture rights to FRS.

The Bank then maintained that the parties could not treat recapture rights as personal property "because the legislature intended that recapture rights be an interest in real property." Thus, from the Bank's perspective, if the recapture rights are real property, the release of security interests would not cover them. The Court did not buy the argument or the Bank's encouraging the Court to look to other statutes such as the Code of Civil Procedure, 735 ILCS 5/12-105, and the Illinois Mortgage Foreclosure Law, 735

ILCS 5/15-1101. The Court felt it was unnecessary because the language of Section 9-5-1, entitled *Reimbursement of subdivide for facilities, roadways or improvements beneficial to public*, was clear and unambiguous. This section provides that whenever a municipality requires a developer to install certain municipal improvements and determines that those improvements may be used for the benefit of other property, the municipality can contract with the developer to reimburse it for a portion of the cost of the improvements. 65 ILCS 5/9-5-1. Such statute provides that the contract between the municipality and the developer "shall" provide that the municipality will collect fees from the owners of the benefited property, before those owners connect to or use the facilities.

The Court maintained that while the legislature authorized municipalities to contract with the developer for reimbursement, the reimbursement is to be funded fees the municipality charges the owners of benefited real properties who use the public improvements. The developer obtains no legal or equitable interest in the benefited properties. The developer's only right is to have the municipality collect fees from the owners of the benefited properties. The owners of the benefited real properties are bound as third parties to the contract between the municipality and the developer.

Because the legislature intended that the owners of the benefited properties pay fees for the use of the improvements, the Court concluded that the developer's rights to those fees cannot be an interest in the properties themselves. The Court determined that the Bank ignored the plain language of Section 9-5-1.

Next, the Bank urged the Court to focus on Section 9-5-2 which provides that a contract such as the FEA shall be recorded:

The recording of the contract . . . shall serve to notify persons interested in such property of the fact that there will be a charge in relation to such property for the connection to and use of the facilities constructed under

the contract.

65 ILCS 5/9-5-2.

The Bank maintained that the recording requirement evidenced an interest in the real properties against which the notice is recorded. However, the Court pointed out that the plain language of Section 9-5-2 states that the purpose of recording the contract is only to give the owners of the benefited properties notice of the charges for connecting to and using public facilities. The charge is not against the benefited properties themselves but is "in relation to such property" for the use of the improvements constructed under the contract between the developer and municipality. The Court characterized the charge as being analogous to a toll for the use of highway or a user fee.

The Bank countered that FRS admitted that the recapture rights were an interest in real property when it recorded memoranda of transactions affecting the recapture rights. The Bank pointed to Huntley Venture's waiver and limitation of the recapture rights in connection with the purchase of strips from the two parcels which maintained that "the obligations described herein are obligations which are pertinent to and which runs [sic] with the land." The Court was unpersuaded and simply observed that whether recapture rights under Section 9-5-1 are an interest in real property is a matter for legislative determination and recording of memoranda with recitals otherwise has no impact on that issue.

The Court also pointed to public policy explaining that Section 9-5-1 is not to protect mortgagees of benefited properties but rather to reimburse the developer for its costs in constructing public improvements. The Court looked to the *Hartz Construction Co. v. Village of Western Springs*, 391 Ill. App.3d 75, 80 (2009) decision which provided that:

The plain language of section 9-5-1 tells us the legislature intended to make a broad grant of authority to municipalities in order to recapture a portion of the costs a developer expends on

improvements. . . .

The court in *Hartz* declared that the legislature intended to place very few restrictions on municipalities' power to recapture costs under Section 9-5-1. It pointed out simply that recapture facilitates development which serves a public purpose. The Court in the *FRS* decision determined that public policy would be frustrated if the statute were interpreted as conferring an interest in benefited properties. The Court maintained that if mortgagees could extinguish the developer's right to reimbursement by foreclosing on benefited properties, growth could be discouraged.

The Court also pointed out that, if the legislature wished, it could have provided that recapture rights pursuant to Section 9-5-1 are a lien on benefited properties. By way of example, the Court pointed out that the legislature provided that when a municipality charges a contiguous unincorporated property for the benefits conferred by local improvements, the amount of the charge is a lien against the benefited property. 65 ILCS 5/9-4-3. It pointed out that when the legislature uses certain language in one part of a statute but uses different language in another part, courts are to assume that different meanings were intended. Ultimately, the Court rejected the Bank's argument that mortgages encompassed the recapture rights. The Court explained that a mortgage is simply an interest in land created by a written instrument providing security in real estate as collateral for payment of a debt. The mortgagor can only grant an interest that he or she holds in the property. In other words, the mortgagee has no greater rights than its mortgagor.

Points to Consider for the Municipal Attorney

The *FRS* decision drives home at least two points when one is working with municipalities.

First, a municipality cannot take at face value the assertion that a financial institution has "foreclosed" recapture rights when it forecloses on property or takes title to same through a deed in foreclosure. Accepting at face value a representation

that recapture rights have been foreclosed or extinguished as true, without proper investigation, can lead to a breach of contract lawsuit if, as was the case in *FRS*, there is contractual agreement between the developer and the municipality to enter into a recapture agreement. Second, recapture rights can be assigned or conveyed like most other personal property. These circumstances harken back to first year property class in law school where the professor would analogize property rights to being a "bundle of sticks" which can be divided up, conveyed, etc. In *FRS*, one party constructed and paid for the improvements, then waived the right through a contract,

which the parties subsequently modified and, in turn, resuscitated the recapture rights which were assigned to still another party and that party in turn assigned the recapture rights back to the party from whom they received them. Aside from obtaining a representation from a party that it has the recapture rights or that they have been extinguished, it is best practice to engage in a due diligence-type investigation, asking for the relevant documentation and verifying with each potentially interested party that the documentation has not been amended, terminated, etc. in order to avoid the litigation that resulted in the *FRS* case. ■