Modern Real Estate Practice in Illinois, 6th Edition
Filmore W. Galaty, Wellington J. Allaway, Robert C. Kyle
Laurie MacDougal, Consulting Editor

Chapter 10: Real Estate Taxes and Other Liens

Learning Objectives

After reading this chapter, students should be able to:

- Identify the various classifications of liens.
- Describe how real estate taxes are applied through assessments, tax liens, and the use of equalization ratios.
- Explain how non-tax liens, such as mechanics' liens, mortgage liens, and judgment liens are applied and enforced.
- Distinguish the characteristics of voluntary, involuntary, statutory, and equitable liens.
- Define the following key terms: ad valorem tax; appropriation; attachment; encumbrance; equalization factor; equitable lien; estate taxes; general lien; general real estate tax; inheritances taxes; involuntary lien; judgment; lien; lien wavers; lis pendens; mechanics' lien; mill; mortgage lien; special assessment; special service areas; redemption; specific lien; statutory lien; subordination agreement; tax deed; tax liens; tax sale.

Why Learn About Real Estate Taxes And Other Liens?

There's an old saying that there are only two things certain in life: death and taxes. As a real estate professional, you'll have to know your share about death (for estate sales and property transfers by will or trust, for instance), but a more crucial issue on your client's mind will be taxes. What's more, properties may be subject to liens, which impose significant limits on both their marketability and, in most cases, their market value. Having some basic knowledge of taxes and liens will help you provide more valuable service to your clients as you guide them through some confusing property ownership issues. Understanding the process of payoff of liens is necessary to estimate a seller's net proceeds in a transaction.

Suggested Items to Bring To Class

1. A detailed set of instructions on how to search the public records in your area for the various types of liens.
2. Sample copies, both blank and completed, of the various tax assessed valuation notices and the tax bills or tax statements used in your area.
3. A copy of the assessed valuation or tax appeal procedures for your area.

Lecture Outline

I. Liens

A charge or claim against property, made to enforce the payment of money. A lien represents only an interest in property; it does not constitute actual ownership: it is an encumbrance on the owner's title. A lien does not necessarily prevent the transfer or conveyance of the property, but conveys along with it.

- Generally, a lien holder must institute a legal action to force the sale of the property or acquire title. The debt is then paid out of the proceeds of the sale.

A. Types of Liens

1. **Voluntary** — created intentionally by the property owner's action.
2. **Involuntary** — created by law.
   a. **Statutory lien** — created by statute.
   b. **Equitable lien** — created when parties agree in writing that a property will be held as security for a debt or other obligation.
3. **General** — affect all the property, both real and personal, of a debtor.
   - A lien attaches to real property at the moment it is filed; a lien does not attach to personal property until the personal property is actually seized.
4. **Specific** — secured by and affects only one specific parcel of real property.

B. Effects of Liens on Title

The existence of a lien does not prevent an owner from conveying title, although the lien might reduce the value of the title holder's equity in the real estate. Once properly established, a lien runs with the land and will bind all successive owners until the lien is cleared.

1. **Priority of liens**

   Refers to the order in which claims against the property will be satisfied. Liens take priority from the date they are recorded in the public records of the county in which the property is located.

   - General rule: first in time, first in line for payment.

   In Illinois there are two exceptions to the general rule: real estate taxes will always take first priority; and a mechanic's lien, if timely recorded, may displace a previously recorded lien.

   a. **Subordination agreements**

The holder of a superior or prior lien agrees to permit a junior lien holder's interest to move ahead of his or her lien. For instance, a seller of raw land to a developer might agree to subordinate his purchase mortgage lien to a lien required by a bank for a loan to build the infrastructure of the subdivision.

II. Real Estate Tax Liens

A. General Tax (Ad Valorem Tax)

Ad valorem refers to taxes assessed according to value of the property.

Exemptions: A variety of property are permanently or temporarily exempt from the imposition of real estate taxes.

IN ILLINOIS….*properties that are exempt from paying general real estate taxes include those used as schools, religious institutions, cemeteries and charitable institutions, as well as those owned by federal, state, county and local governments. Taxing districts may elect to exempt certain other properties (with some limits), such as commercial and industrial properties in order to encourage development.*

Illinois property taxes are adjusted to reflect certain concessions given on owner-occupied residences. These properties are designated as homesteads. The homestead exemption reduces the assessed value of a property subject to taxes. This exemption is not to be confused with the homestead life estate discussed in Chapter 7. There are two exemptions. The ***Homeowner's Exemption*** *applies to owners of single-family homes, condominiums, cooperatives and one- to six-unit apartment buildings. Owners must apply to the assessor for the exemption each year. The* ***Senior Citizen's Homestead Exemption*** *is available to homeowners over the age of 65. Once an individual has demonstrated eligibility for this exemption by age and ownership, it is automatically applied as long as he or she owns the property as a primary residence. These entitlements reduce the amount of general taxes but expire when ownership transfers. The* ***Senior Citizen's Assessment Freeze Homestead Exemption*** *allows Illinois seniors to freeze their assessed valuation for the remainder of their lifetime once they have turned 65, if household income does not exceed $55,000. The Homestead Improvement Exemption allows any Illinois homeowner who has recently improved his or her home to forestall an increase in the home's overall assessed value for up to four years. This exemption is available up to an improvement value of $75,000.*

Property owners may qualify for other tax concessions based on their status as disabled veterans or improvements to the property, certain maintenance and repair expenses, solar heating, airport land, *farmland, rehabilitation of historic buildings and location within enterprise zones or tax concession districts.*

2. Assessment

Real estate is valued for tax purposes by county or township assessors or appraisers. This official valuation process is called assessment.

IN ILLINOIS . . . *Counties with populations in excess of one million may divide the county into three geographical areas. Each area will be assessed once every three years. All assessments are published in full in a newspaper of general circulation serving the area of the property, and a written notice is sent to the taxpayer of record. The assessment official may adjust the assessed value yearly on those parcels whose use has changed during the intervening years.*

In all counties except Cook, real property is assessed at 33 1/3 percent of fair market value. (Depending on how the property is classified, real property in Cook County is assessed based on a sliding scale of percentages of fair market value, from 16 to 38 percent.) The Illinois Revenue Act defines real property as including land, buildings, structures, improvements and any other permanent fixtures attached to land.

Taxpayers who believe that errors were made in their property's assessment may file a complaint directly with this assessment official (in Cook County, the official is called the county assessor; in other counties, he or she is usually called the supervisor of assessments. If the taxpayer's complaint is denied, the decision may be appealed to an administrative board of review (in Cook County, this body is called the Board of Appeals). Alternatively, the taxpayer can bypass the county official and go directly to the board of review. If the taxpayer is dissatisfied with the board's decision, he or she may file an administrative appeal or request a review of the decision by the circuit court of the county in which the property is located.

3. Equalization

When it is necessary to correct inequalities in assessments, an equalization factor is used. An equalization factor may be applied to raise or lower assessments in a particular district or county. Equalization is important to local governments because state-funding of programs (such as education) is often based on the assessed value of local real estate. The assessed value of each property is multiplied by the equalization factor, and the tax rate is applied to the equalized adjusted assessment.

IN ILLINOIS . . . *the assessed valuation of all real estate is adjusted yearly in each county by applying an equalization factor determined by the Property Tax Administration Bureau of the Department of Revenue. Assessed* *values are compared with selling prices to arrive at an equalization factor, and each county is assigned a multiplier to be used for equalization purposes. The equalizer is applied before any applicable homeowner's exemptions are deducted.*

4. Tax rates

The process of arriving at a real estate tax rate begins with the adoption of a budget by each taxing district. The net amount to be raised from real estate taxes is determined. *Appropriation* is the way a taxing body authorizes the expenditure of funds and provides for the sources of the funding. The amount to be raised from the general real estate tax is then imposed on property owners through a tax levy, the formal action taken to impose the tax.

- To arrive at a tax rate, all non-real estate related revenue is subtracted from the total budget requests. Whatever remains must come from real estate taxes. The balance of the budget requests are then divided by the total assessments of all real estate located within the taxing body's jurisdiction.

5. Tax bills

A tax bill is computed by applying the tax rate to the assessed value.

IN ILLINOIS . . . *the county collector prepares and issues only one combined tax bill to each parcel of property*.

General real estate taxes are levied annually for the calendar year and become a prior first lien, superior to all other liens, on January 1 of that tax year. However, they are not due and payable until the following year.

The general rule is that real estate taxes are payable in two equal installments in the year after they are levied: one-half by June 1 and the second half by September 1. These payment dates are called penalty dates, after which a 1½ percent-per-month penalty is added to any unpaid amount. Because bills must be issued 30 days prior to a penalty date, the penalty date for an installment may be delayed if the county collector is late in preparing the bills.

Cook County tax bills are handled in a different manner. The county's penalty dates are March 1 and August 1 having been authorized under an accelerated billing procedure. With this accelerated procedure, the billing for the installment due March 1 is sent before the actual tax has been determined. The amount of this first accelerated installment is one-half the amount of the tax bill for the previous year. The second installment is then billed after the tax has been determined and is for the actual tax less the amount billed as the first installment.

6. Enforcement of tax liens

Real estate taxes must be valid to be enforceable.

IN ILLINOIS . . . *when a property owner fails to pay taxes on real estate, the property may ultimately be sold at an annual tax sale, at a forfeiture sale, or at a scavenger sale.*

Annual sale. *If the taxes on a property have not been paid by the due date of the second installment, the county collector can enforce the tax lien and request the circuit court to order a tax sale. The county has strict notification requirements, which are prescribed by statute. The court will render judgment in favor of the county if the taxes are shown to be delinquent and proper notice has been given. The court order allows only the sale of the tax lien, not the property itself.*

Prior to the time of sale, the owner and any other party with a legal interest (except undisclosed beneficiaries of a land trust) may redeem the property and stop the sale by paying the delinquent taxes, interest and publication costs. Successful purchasers at the sale are those who offer to pay all outstanding taxes, interest, publication costs, processing charges and the county treasurer's indemnity fund fee.

Forfeiture sales. *If there are no bids on a property at the annual tax sale, the property is forfeited to the state. The owner may redeem the property any time after forfeiture by paying delinquencies, publication costs and interest. If the owner does not claim the property within 30 days of notification, anyone who applies to the state will be issued a certificate of purchase once he or she pays the outstanding taxes, interest and other fees.*

Scavenger sales. *If the taxes have not been paid on a property for two years or more, the property may be sold at a scavenger sale. The county must go through the same court process as it would for tax sales and receive an order of sale. The successful bidder at these sales is the one who is willing to pay the highest cash price for the property. The buyer is not required to pay the tax lien, but must pay current taxes. Former owners may not bid on their delinquent properties.*

7. Special Assessments (Improvement Taxes)

Special assessments are taxes levied on real estate to fund public improvements to the property. Special assessments are specific and statutory, but can be either involuntary or voluntary liens. Each property in the improvement district is charged a prorated share of the total amount of the assessment.

IN ILLINOIS . . . *special assessments are usually due in equal annual installments over a period of three to ten years, with the first installment usually due during the year following the public authority's approval of the assessment. The first bill includes one year's interest on the property* *owner's share of the entire assessment; subsequent bills include one year's interest on the unpaid balance. Property owners have the right to prepay any or all installments to avoid future interest charges. The annual due date for assessment payments in Illinois is generally January 2.*

B. Special Service Areas (SSAs)

IN ILLINOIS . . . *Special Service Areas (SSAs) are special taxing districts in municipalities that are established by ordinance, often by developers, in order to pass on the costs of streets, landscaping, water lines and sewer systems to homeowners who reside within the SSA.*

III. Other Liens on Real Property

A. Mortgage Liens (Deed of Trust Liens)

Voluntary lien on real estate given to a lender by a borrower as security for a real estate loan. It becomes a lien on real property when the lender records the documents in the county where the property is located.

B. Mechanics' Liens

A specific, involuntary lien that gives security to persons or companies that perform labor or furnish material to improve real property.

IN ILLINOIS . . . *to be entitled to a mechanic's lien, the person who did the work must have had a contract (express or implied) with the owner or the owner's authorized representative. If improvements that were not ordered by the property owner have commenced, the property owner should execute a document called a notice of nonresponsibility to relieve themselves from possible mechanics' liens. By posting this notice in some conspicuous place on the property and recording a verified copy of it in the public record, the owner gives notice that he or she is not responsible for the work done.*

A person claiming a mechanic's lien must file a notice of lien in the public record of the county in which the property is located within four months after the job (or, in the case of subcontractors, their part of the work) is completed. Subcontractors have the right in Illinois to file for their unpaid claim, even when the general contractor has been paid in full.

Priority. *Mechanics' liens can take priority over a previously recorded lien if the work done has enhanced the value of the property. The lien attaches as of the date when the work was ordered or the owner signed the contract. The date of attachment establishes the lien's priority over other liens.*

Waiver and disclaimer. *The general contractor in a sworn statement, which is presented to the landowner who ordered the work, must list* *the names of all subcontractors. The landowner should collect waivers of lien from each contractor, subcontractor, materials supplier and property manager as each payment is made. This creates a continuing record that all lien claimants have released their lien rights.*

Expiration. *The contractor's lien right will expire two years after completion of that contractor's work, unless he or she files suit within that time to foreclose the lien. This suit can force the sale of the real estate to provide funds to pay the claimant's lien.*

C. Judgments

An order issued by a court that finally settles and defines the rights and obligations of the parties to a lawsuit. A judgment is a general, involuntary lien on both real and personal property owned by the debtor.

IN ILLINOIS . . . *a judgment becomes a general lien on all of the defendant's real and personal property in a county at the time the judgment is recorded in the county recorder's office. Judgment liens are effective for seven years and may be renewed for another seven-year term.*

1. **Lis pendens:** a special notice recorded when any suit is filed that affects title to real estate. A lis pendens is notice of a possible future lien or a change in ownership rights. The recording date of the lis pendens determines the recording date of any future claim against the property.
2. **Attachments:** a writ authorizing the court to retain custody of the property until a lawsuit involving the property concludes.

D. Estate and Inheritance Tax Liens

Federal estate taxes and state inheritance taxes (as well as the debts of decedents) are general, statutory, involuntary liens that encumber a deceased person's real and personal property.

E. Liens for Municipal Utilities

Municipalities may impose a specific, equitable, involuntary lien on the property of an owner who refuses to pay bills for municipal utility services.

F. Bail Bond Lien

A defendant may post bail in the form of equity in real estate. The execution and recording of a bail bond creates a specific, statutory, voluntary lien against the owner's real estate.

G. Corporation Franchise Tax Lien

State governments generally levy a corporation franchise tax on corporations as a condition of allowing them to do business in the state.

Such a tax is a general, statutory, involuntary lien on all real and personal property owned by the corporation.

H. IRS Tax Lien

A federal tax lien is a general, statutory, involuntary lien on all real and personal property held by a delinquent taxpayer. This lien becomes effective when the IRS records it not at the time of the alleged tax liability.

IN ILLINOIS . . . *the Commercial Real Estate Broker Lien Act permits commercial brokers to place a lien on property in the amount of the commission they are entitled to receive under a contract involving either the sale or lease of commercial property in the event they are not paid for their services. The lien applies to commercial property only and must be recorded to be enforceable.*

Discussion Questions

1. What is the effect of priority regarding liens?
2. How does the priority of lien rule effect real estate claimants?
3. Who specifically are the taxing authorities in your area?
4. W hat can cause tax rates to increase or decrease?
5. What is the process used in determining the amount of ad valor taxes?

Classroom Exercises

1. Obtain a preliminary title commitment (with names and other identifying information deleted or obliterated) that illustrates the various types of liens. Show it to your class as lien priorities are discussed.
2. Arrange to have an employee speak with your class or secure documents from the tax assessor’s office to help explain the local assessment and taxation processes.
3. Generate a "time line" for the assessment of property and the levy, payment, delinquency, and foreclosure of real estate taxes. Ask your students to draw this time line on the board.
4. Generate a “time line” for determining the order of payout when there are multiple liens recorded against the property.

