



# Underwriting Broken Priority and Mechanics Lien Issues

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## Basic Terminology

- **Lienor or Claimant:** Party claiming the right to a lien.
- **General Contractor or Prime Contractor:** Contractor that has direct contact with the property owner or owner's agent. Same states also define owner-builders as General Contractors. (See, e.g., Wash. Rev. Code § 60.04.011(12)).
- **Contracting Party/Owner:** Many state statutes define the Owner as the party requesting, or whose agent is requesting, that work be completed.

## Basic Terminology, Con't.

### Lienable Work a.k.a. “Improvements

- **Lienable Work:** Definition varies by state, but work performed or materials provided must meet definition to qualify for lien rights.
- “Constructing, altering, repairing, remodeling, demolishing, clearing, grading, or filling in, of, to, or upon any real property or street or road in front of or adjoining the same....” (Wash. Rev. Code § 60.04.011(5))

## Statutory Authority



### **RCW 60.04.021**

#### **Lien authorized.**

Any person furnishing labor, professional services, materials, or equipment for the improvement of real property shall have a lien upon the improvement for the contract price of labor, professional services, materials, or equipment furnished at the instance of the owner, or the agent or construction agent of the owner.

## Property Subject to a Lien

### **RCW 60.04.051**

#### **Property subject to lien.**

The lot, tract, or parcel of land which is improved is subject to a lien to the extent of the interest of the owner at whose instance, directly or through a common law or construction agent the labor, professional services, equipment, or materials were furnished, as the court deems appropriate for satisfaction of the lien.

## Property Not Subject to a Lien,

- Works of public improvement and property owned by the United States, any state, municipality or other governmental entity
- Contracting Party is not the fee simple owner

## Attachment and Priority

- Generally, a lien will have priority over other interests if the lien attaches to the property prior to the recording of the subsequent interest.
  - Recording of Lien Notice
  - Commencement of Work

## Timeline for filing and executing

- In Washington the lien claimant has 90 days after work has ceased to be performed or materials delivered to record a lien. The priority relates back to when the work was commenced, as noted on the lien form.
- The lien claimant then has eight months to commence an action to foreclose the lien.
- If the case is not prosecuted to judgment within two years the court at its discretion may dismiss the action for want of prosecution.

## Attachment and Priority Con't.

- Broken Priority and Relation Back
- Possible, but difficult to regain priority once broken
- If a lien claimant does work on the property and executes a lien waiver, then at a later date provides additional work or services for the project, their priority status may relate back to their original start date, despite the execution of a lien waiver. A.A.R Test Lab. V, New Hope Church, 112 Wn. App, 442 (Wash. Ct. App. 2002)

## Attachment and Priority Con't.

Due to case law, it is appropriate to obtain subordination agreements in addition to lien waivers from all possible lien claimants who provided work, materials or professional services for the project

## Lienable Work Revisited, Con't. General Rule

- The definition of “commencement of work” varies by state, but a good rule of thumb is that work has commenced when there is visible evidence of work performed or the presence of materials or equipment.
  - Would a reasonable person look at the subject property and understand that work was underway?

## **RCW 60.04.161**

### **Bond in lieu of claim.**

A bond issued by a surety company authorized to issue surety bonds in the state. The surety shall be listed in the latest federal department of the treasury list of surety companies acceptable on federal bonds, published in the Federal Register, as authorized to issue bonds on United States government projects.

# Defenses

- Claimant's failure to strictly comply with statutory rules or deadlines.
  - Timely filing
  - Proper forms
  - Correct legal description
  - Correct Amount



## Underwriting Considerations

Lenders Mechanic's Lien Coverage is usually provided by deleting the standard mechanic's lien exception.

C. Extended coverage exceptions as follows:

4. Any lien, or right to a lien, for services, labor or material heretofore or hereafter furnished imposed by law and not shown by the public records.

NOTE D: All matters regarding extended coverage have been cleared for the mortgagee's policy.

Exceptions C, E, and F shown in Schedule B herein will be omitted in said extended coverage mortgagee's policy.

# Underwriting Considerations

Owners Mechanics lien coverage is provided in the expanded owners policy.

8. Someone else has a lien on Your Title, including a: (e) lien, occurring before or after the Policy Date, for labor and material furnished before the Policy Date.

Standard Owners policies afford no coverage.

## **EXCEPTIONS FROM COVERAGE**

Any lien, or right to a lien, for services, labor or material theretofore or hereafter furnished, imposed by law and not shown by the public records.

## Mechanics Lien Endorsements

- The ALTA 32-06, 32.1-06 and 32.2-06 Construction Loan Endorsements are designed to be used solely with ALTA Endorsement 33-06 (Disbursement). Issuance of the ALTA Endorsement 33-06 will require proof of payment to mechanic's lien claimants. Such proof is usually provided by paid bills, receipts, lien waivers, etc. Refer to the Guidelines for the ALTA Endorsement 33-06 (Disbursement).

Modifies section 11,a of the lenders policy.

The lack of priority of the lien of the Insured Mortgage upon the Title, for advance of proceeds.

# Mechanics Lien Endorsements

## ALTA Endorsement 14-06

We have two versions of the endorsement - one which contains mechanic's lien exception (Endorsement 14 W/MML at paragraph 4.f) and the other which does not contain the mechanic's lien exception (Endorsement 14 WO/MML).

# Underwriting Considerations, Con't

## Pre-Construction

- Many mechanic's lien claims can be avoided by a proper pre-recording inspection of the subject property
  - Conducted immediately prior to recording
  - Time and date stamped photos of the entire property
  - Annotated survey accompanied by written statement from the inspector
  - Supplemental inspection if recording is delayed
- Inspector should be looking for visible evidence of commencement of work
  - Call to stop recording in the event that work has commenced

# Underwriting Considerations, Con't

## Post-Construction

- Confirm that all work done on the entire project has been paid for in full
  - Use caution when obtaining lien waivers or subordination documents
- Remember! Insuring the conversion from construction to permanent financing does not necessarily mean that all work was paid for under the construction loan.

# Underwriting Considerations, Con't

## Known Broken Priority

Do not insure without underwriter approval!

• In limited circumstances, an underwriter may still wish to insure after consideration of some or all of the following issues:

- Previous track record of the owner/contractor
- Availability of Indemnity Agreements
- Financial condition and history of the owner
- Equity in the project
- Anticipated cash flow (including from other sources)
- Status of leases and occupancy rates
- Construction contract and budget
- Disbursement procedures
- Bonds

## Lienable Work Revisited.

Mannington Carpets, Inc. v. Hazelrigg, 973 P2.d 1103  
(Wash. Ct. App. 1999)

- Carpet supplied for commercial office building
- Materials shipped from factory before deed of trust was recorded but delivered after recording
- Carpet supplier claims priority
- Holding: The right to a materialmen's lien does not arise where the materials have been shipped but not yet delivered.

# Avoiding Common Claims

## Hypothetical #1

- Mechanic's Lien coverage for deed of trust securing a large loan financing the construction of a new residential subdivision.
- Lender rep says "take my word for it", work has not yet started.
- Ok to insure

# Avoiding Common Claims, Con't

## Hypo #1, Con't

- Short Answer: No!
- Conduct proper inspection
- Lenders, especially non-local banks, may not be aware of everything happening at the construction site.

# Avoiding Common Claims, Con't

## Hypothetical #2

- Construction on a multi-million dollar ski villa commenced six months ago
- Owner has been paying some, but not all parties out of pocket. Initial draws are intended to pay all outstanding invoices
- Pre-policy search does not show any recorded liens
- Ok to insure?

# Avoiding Common Claims, Con't

## Hypo #2, Con't

- Short Answer: No!
- Classic example of broken priority
- Underwriter approval required in addition to lien waivers, indemnity agreements, etc.

## Avoiding Common Claims, Con't Hypothetical #3

- Construction loan deed of trust is foreclosed
- Lender re-selling to third party
- Pre-policy search shows recorded liens that appear junior
- Ok to insure?

# Avoiding Common Claims, Con't

## Hypo #3, Con't

- Short Answer: No!
- Priority may be based on commencement of work and not recording date of liens
- Methods for determining status of priority
  - Statutory deadlines

# In Closing

Questions ?

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