

Not Getting Paid?

An Outline Discussing Pre-Lien Notice, Mechanic's Liens and Foreclosure

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With the economy in decline, our remodeling, construction, banking, and supplier clients are often suffering with delinquent accounts.

This outline discusses and explains some general information about mechanic's liens and using them to collect unpaid account.

I. WHAT IS A MECHANIC'S LIEN?

A. **Definition:** A mechanic's lien is a remedy created by statute to secure payment for labor, skill, materials or machinery furnished in the improvement of specific real property on behalf of another person.

1. In other words, if someone is not paid who performs work or provides materials for building on or improving real estate, that unpaid person may claim a lien against the real property in question.
2. There are certain steps a mechanic's lien claimant must follow to be entitled to claim a lien against the subject property. However, if these steps are followed, there may be serious consequences for the property owner.

B. **Consequences:** If a builder, remodeler, subcontractor, material supplier or other entity validly perfects a mechanic's lien in connection with a parcel of real property, that entity will have the right to foreclose upon the property and sell it in satisfaction of its unpaid bill. Unless someone pays the bill or otherwise settles the matter, the property could be taken away from the owner and given to the contractor (subject to any senior liens).

1. Although a lien claimant has the right to foreclose if it follows certain rules and meets certain deadlines, it is not usually as easy as the foregoing indicates. A mechanic's lien foreclosure can be and often is a very complicated and time consuming legal proceeding. The cost and hassle commonly associated with mechanic's lien foreclosures will sometimes deter a lien claimant from actually commencing a foreclosure.
2. There is usually a reason that the property owner is not paying the lien claimant's bill. For instance, maybe the electrician did a poor job and the owner does not think the entire bill is warranted. Alternatively, the owner

might have already paid a lump sum to the general contractor who neglected to pay the electrician. In that case, the electrician has claims against the owner's property and the general contractor directly. In turn, the general contractor has potentially gained a windfall, and the property owner might be faced with paying twice for the electrician's work.

3. A mechanic's lien foreclosure requires a lawsuit. The lien claimant sues the homeowner and anyone else with a legal interest in the real property (*i.e.* mortgage holders, other mechanic's lien claimants, a condominium association holding a lien for unpaid dues, etc.). In the lawsuit, the lien claimant asks the court to order the real property to be sold in satisfaction of its claim for payment. If the lien claimant is successful and the case is not settled, the court will order the property to be sold in satisfaction of the debt.
4. If the property is sold, any liens or encumbrances superior in right and/or time to the foreclosing claimant's mechanic's lien (such as the first mortgage) will remain as liens against the property. In other words, a victorious lien claimant will take the real property subject to any senior liens. A "senior lien" can be generally defined as one filed prior to yours. However, all valid mechanic's lien claimants have equal priority, regardless of who filed their lien first.

C. **The Rules:** There are certain rules a general or subcontractor must follow in order to claim a lien and attempt to foreclose in pursuit of payment. These will be generally met if the lien claimant:

1. Provides labor or materials in connection with building upon or improving real property;
2. Has a bill for those items that has not been paid in full;
3. Subcontractor: Provides adequate "pre-lien notice" to the owner (if required by law) within 45 days of beginning work on or contributing materials to the property.

General Contractor: Provides pre-lien notice in its written contract with the property owner. If there is no written contract, pre-lien notice must be provided by personal service or certified mail within 10 days after the work is agreed upon.

A pre-lien notice informs the property owner that the entity providing the notice might be entitled to file a lien if its bill is not paid. It also tells the owner that, if necessary, he/she may withhold payment from the general contractor sufficient to pay the subcontractor directly. If a pre-lien notice was required and an entity did not provide it, that entity may not enforce a mechanic's lien;

4. Files with the county recorder or registrar of titles a mechanic's lien statement referencing the real property in question and stating the amount actually owed and/or reasonable value of the work performed at the time of filing. This document must be filed within 120 days of the claimant's last day of work on the property; and
5. Starts or joins a lawsuit to foreclose upon its mechanic's lien within one year from the last date of work on the property. Note that this one-year period runs from your last date of work, *not from the date the lien was filed*.

II. HOW CAN MECHANIC'S LIENS AFFECT PROPERTY OWNERS?

- A. **New Construction**: If the general contractor/developer does not pay all of the subcontractors working on the project, liens claimed by these unpaid contributors could complicate the closing. Real estate cannot be conveyed unless all valid lien claims are paid or otherwise settled or provided for at closing.
- B. **Existing Homes and Buildings**: Remodeling jobs, additions, etc. can involve a different path to collection through a mechanic's lien. This is because there might not be a closing in the near future that would require the lien to be paid. If you work on an existing house or building and do not receive payment, the owner might ignore the lien until it expires in one year. If this is the case, the unpaid contractor will likely need to foreclose to try to force payment. Of course, the lien still carries great weight, because the owner cannot refinance or sell the property while the lien is alive without first paying your lien. Still, you should consult an attorney about your options if a closing is not in sight, because there are many factors to consider before foreclosing.
- C. **Condominium and Townhouse Associations**: If the board of directors retains a contractor to repair or improve structures or elements within the association, there is a potential risk to all owners:
 1. ***Common Elements/Areas***: If a contractor repairs or improves common elements/areas within the association, liens could be filed against those properties if the general contractor or subcontractors working on the project are not paid. In a condominium this could have additional consequences, *i.e.* if the common roof is repaired in an apartment-style condominium development, unpaid contractors could claim liens and attempt to foreclose upon the entire building.
 2. ***Individual Units***: In any type of community association (condominium, townhouse, cooperative, single-family home), pursuant to the association's typical maintenance responsibilities the board of directors routinely hires contractors to work on the individual units. As an example of the potential impact of our state lien laws, if a siding contractor or subcontractors (or even the siding supplier if they deliver materials to the property) are not paid and they follow the rules, they could claim liens against *every unit*. Mass

foreclosure against all units are not likely to be well-received by the unit owners, and the association and the board of directors certainly do not wish to deal with irate owners demanding that liens be removed from their properties. Further, even though an owner's dues are generally intended to pay for such services as painting and roofing, etc., if a mechanic's lien exists at the time an owner desires to sell, the owner may be faced with paying the lien claimant directly to allow the closing to occur. To put it mildly, this does not usually make for good relations between the affected owner and the association, no matter who is at fault in the situation.

III. WHAT IS A LIEN WAIVER?

- A. A lien waiver is a written affirmation from a contractor that provided labor, skill or materials to improve the property. The waiver specifically states that the entity has either been paid, or alternatively agrees that it has no right to claim a lien against the property. The general contractor should provide the owner with lien waivers for all subcontractors working on the project.
- B. The owner may withhold enough money from the general contractor to pay the claims and satisfy the liens of any subcontractors or other entities that the general contractor has failed to pay.
 - 1. The owner may pay and discharge all such liens and deduct these costs from the contract price.
 - 2. No owner is required to pay the general contractor until the expiration of 120 days from the completion of the improvement, *except* to the extent that the contractor furnishes the owner with lien waivers signed by all entities that furnished labor, skill or materials to the property *and* who gave "pre-lien notice" (see part I.C.3 above). Note that the foregoing time period refers to the last possible date any claimant could file a mechanic's lien against the property, *i.e.* 120 days from the last date of work on the premises (see part I.C.4 above).
- C. A lien waiver given without adequate consideration is generally not enforceable. Unless the lien claimant actually receives payment or some other equivalent compensation in connection with the lien waiver, the owner may not rely upon the waiver and a lien could possibly still be filed within 120 days of the claimant's last day of work.

IV. MORTGAGE FORECLOSURES

- A. **What does a mortgage foreclosure do to my lien?** The short answer is that a mortgage foreclosure will generally wipe out your lien unless you take certain steps to protect it.

1. ***Redemption:*** Generally the mortgage or construction finance company will have a first lien on the property. This means that if it forecloses on the property to collect its unpaid balance on its loan, any junior liens (including mechanic's liens) will be extinguished unless those lien holders "redeem," which involves paying off the mortgage.
 - a. Notice of Intention to Redeem: Redeeming involves first filing a document against the property after the mortgage foreclosure sale. This document is called a Notice of Intention to Redeem. This document must be filed within the "redemption period," which is the waiting period after a foreclosure sale. If the foreclosure was involuntary, meaning the property owner is not cooperating with the foreclosure, the redemption period is typically 6 months. In a voluntary foreclosure, where the owner agrees to let the mortgage company foreclose, the waiting period is typically only 2 months.
 - b. Paying off the first mortgage: If you have a valid lien and filed a Notice of Intention to Redeem during the redemption period, you will have the right to buy the property, *i.e.* to pay off the liens ahead of you and take over the property. The purpose of doing so would be to then sell the property to get your money back, and also to pay off your own lien. This can be expensive and complicated, and you should always seek legal advice in this situation to determine your options and whether or not redemption is advisable in the given situation.
2. ***Deciding not to redeem:*** If you do not redeem, you risk losing your lien. The mortgage company will typically *not* be required to pay off your lien when it takes over the property. However, under some limited circumstances you might still be paid without redeeming, such as:
 - a. Sale of property: If the property is sold before the redemption period expires, a valid lien will need to be paid at closing.
 - b. Work pre-dates the mortgage filing: If any of the contractors that worked on the job started work to visibly improve the property *before the mortgage was filed with the county*, all of the valid liens will potentially be senior in priority to the first mortgage. If this is the case, the foreclosing mortgage company will take over the property subject to the valid liens, and will need to pay them at closing if the property sells while your lien is still alive.
 - c. Larger lien holders buy you out: Sometimes another lien holder with a large claim will offer to pay off smaller liens at a discount. This may be a good option if you do not have the financial ability to buy the property and pay off the mortgage, or if your lien amount is relatively small and you just want to obtain some money and move on.