



California Land
Title Association

Mechanics' Liens

WORK SET # 2

Provided by
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California Land Title Association
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THE MECHANICS' LIENS WORKBOOK

For approximately the last thirty-five years, title insurance companies have provided mechanic's lien coverage to lenders where priority has been lost for the deeds of trust securing construction loans. Losses for mechanic's lien claims are the fourth largest category of claims for the title industry, behind searching errors, basic risk, and forgery. The substantial risks undertaken by the title industry in issuing mechanic's lien coverage can appropriately be described as "credit" and "casualty" risk.

WHAT IS A MECHANIC'S LIEN?

The California Constitution empowered the Legislature to enact laws providing a powerful lien remedy in favor of materialmen and laborers providing material and labor for a work of improvement.

“Mechanics, persons furnishing materials, artisans, and laborers of every class, shall have a lien upon the property upon which they have bestowed labor or furnished material for the value of such labor done and material furnished; and the Legislature shall provide, by law, for the speedy and efficient enforcement of such liens.” Cal Const, Art XIV § 3 Mechanics' liens

The California legislature has enacted laws providing the lien claimant with a foreclosure remedy to enforce a mechanic's lien. The California Constitution and the mechanic's lien legislation evidence a real public concern that the just claimant be paid. See California Civil Code §§ 3082 et seq.

It is helpful to keep in mind while reading this material that the:

- * mechanic's lien claimant's fundamental objective is to get paid and
- * the claim of mechanic's lien is the claimant's security used to reach the objective of payment

This public concern that the claimant reach their object is so strong, that even though a general contractor has been paid everything due the contractor and all the sub-contractors, if the general contractor runs off with the money, the owner could be forced to pay what was due the sub-contractor a second time.

THE PRIORITY OF A MECHANIC'S LIEN

Under California Civil Code § 3134, the priority of the mechanic's lien relates back to the date of "the commencement of the work of improvement". As a result, if a Deed of Trust records after the commencement of the work of improvement, then a subsequently recorded mechanic's lien will be entitled to priority over the earlier recorded Deed of Trust. In title jargon, there is a "break in priority", typically requiring underwriting approval prior to recording and insuring of the lender's Deed of Trust.

The priority of a mechanic's lien can not be determined by a search of record title. The priority of mechanics' liens is unique compared to most other liens in that the priority of a mechanic's lien is not determined by the time of creation or date of constructive notice by recordation (regarding priority for most liens, see California Civil Code § 2897 –FIRST IN TIME and California Civil Code § 19 CONSTRUCTIVE NOTICE).

The priority of a recorded mechanic's lien will relate back to the date work first began on the work of improvement (the commencement of the work of improvement). (See California Civil Code § 3134) The result is that a later recorded mechanic's lien will have priority over a Deed of Trust recorded after the commencement of the work of improvement. The mechanic's lien claimant will be in a position to foreclose and establish the priority of the mechanic's lien against the lender's deed of trust.

"visible to the eye" TEST

The California Courts have adopted a visibility test for determining the date for the commencement of the work of improvement. Case law supports the relation back of a mechanic's lien to the date work on the ground was "visible to the eye", "easily seen by everybody", and such that a person viewing the site could "readily see and recognize" the commencement of the work of improvement.

In title jargon, there is a "loss of priority", a "break in priority" for the insured's deed of trust as against mechanics' liens where the work of improvement commenced prior to the recordation of the insured's deed of trust.

PROCEDURAL REQUIREMENTS

The Conditions for Enforcing a Mechanic's Lien:

Foreclosure of a mechanic's lien is a very powerful remedy. However, the law is extremely technical in this area with mandatory notice requirements and short time periods for enforcement.

PRELIMINARY 20-DAY NOTICE

Except one under direct contract with the owner, every person who furnishes labor, service, equipment, or material for which a mechanic's lien can be claimed, must give the preliminary 20-day notice (private work) required by California Civil Code §3114. See also California Civil Code §3097 for content requirements. Those persons having a direct contract with the owner are not required to give the preliminary 20-day notice. THIS NOTICE IS NOT RECORDED.

There are different time periods for the filing of the mechanic's lien depending upon whether the claimant is an original contractor (i.e., the general contractor), a material supplier, or a sub-contractor or other person involved with the project.

An original contractor must record the claim of lien (the mechanic's lien) after the original contractor completes his contract and before the expiration of (a) 90 days after the completion of the work of improvement, or (b) 60 days after recordation of a notice of completion or notice of cessation. In other words, the recordation of a notice of completion or notice of cessation shortens the time period for the original contractor to file a mechanic's lien.

California Civil Code § 3115

All other claimants must record the claim of lien (the mechanic's lien) after they cease furnishing labor, services, equipment, or materials, and before the expiration of (a) 90 days after the completion of the work of improvement, or (b) 30 days after recordation of a notice of completion or notice of cessation. California Civil Code § 3116

Usually, the longest period a mechanic's lien can bind property is 90 days unless within that time period an action is commenced in Court to foreclose upon the mechanic's lien (California Civil Code § 3144). However, beware of the ability of the lien claimant to record a later duplicate mechanic's lien. There is an exception where the owner and claimant agree to extend the time period up to, but not exceeding, one (1) year and notice of this time credit is recorded. California Civil Code § 3144.

NOTICE OF COMPLETION

A Notice of Completion is a written notice, signed and verified by the owner or his agent, containing certain information regarding the land on which construction has been completed (California Civil Code §3093). If otherwise valid and recorded within 10 days of the completion of construction, the time in which claimants may file mechanics' liens is limited.

Another factor affecting the validity of a Notice of Completion is the owner's compliance with California Civil Code §3259.5, which requires that the owner give written notice to certain persons that a Notice of Completion or Notice of Cessation has been recorded.

Further, a Notice of Completion must not be recorded until the last person or company that could record a Mechanic's Lien has completed their work. Often you will get a request to issue one of 101 series of endorsements based on a Certificate of Occupancy. This Certificate is issued by the local government agency prior to the actual completion of the project. Items still left undone may include landscaping and outside painting. It would be inappropriate to record the Notice of Completion when the project is not finished.

Although not described here, a valid, recorded Notice of Cessation has an effect similar to that of a Notice of Completion (California Civil Code §3092).

DESIGN PROFESSIONALS' LIENS

Legislation in 1990 established a "design professional" lien in favor of any "certified architect, registered professional engineer, or licensed land surveyor who furnishes services pursuant to a written contract with a landowner for the design, engineering, or planning of a work of improvement". Note the absence of any reference to other parties who may facilitate the early stages of a development; for example, the real estate appraiser is not entitled to a lien. Professionals performing such tasks as appraising, legal work, and brokerage activities, are never entitled to a design professionals' lien, or a mechanic's lien for that matter.

The result of this new legislation is the establishment of a lien in favor of a group of professionals performing work before the "visibility test" would establish the commencement of a work of improvement. It is for those common situations where work is performed in anticipation of a work of improvement, but the actual work of improvement never commences on the site.

However, these professionals are not entitled to record their lien unless a building permit or other government approval in furtherance of the work of improvement has been obtained in connection with or utilizing the services of the design professional. It appears to be a difficult lien to enforce. For example, there are unique mailing and recording requirements. In California Civil Code § 3081.2, the landowner contracted for the design professional's services and is also the owner of the real property at the time of recordation of the lien and in California Civil Code § 3081.3, the lien has a life of 90 days or less and under in California Civil Code § 3081.4. the design professional must record a notice of pending action within the 90 day period.

RELEASE OF LIEN BOND

Any recorded mechanic's lien may be ignored, upon approval of Management, in reliance upon a statutory release of lien bond which complies with the provisions of California Civil Code §3143.

The purpose of this bond is to release a recorded claim of mechanic's lien or notice of pending action which is disputed as incorrect or invalid. It may be used by an owner, original contractor, or subcontractor. It may be given before an action is commenced to enforce the lien or after an action has commenced, but prior to judgment. It is required that a bond be executed by a corporation authorized to issue surety bonds in the State of California in a penal sum equal to 1 1/2 times the amount of the claim or 1 1/2 times the amount allocated in the claim of lien to the parcel or parcels of real property sought to be released. The bond shall be for the payment of any sum which the claimant may recover on the claim together with his cost of suit in the action, if he recovers. Upon the recording of such bond the real property described in such bond is released from the lien and from any action brought to foreclose such lien.

LOSS OF PRIORITY TRANSACTIONS

Now that you understand the risk factors, you can appreciate the benefit of your underwriting department. Few local operations have authority to insure over loss of priority. Complete loss of priority packages will avoid delays receiving approval. Yet, how is one to know if their project is a solid one? The underwriter's perspective is little different than that of a lender when determining the developer's ability to complete the project?

THE 125% TEST

The Indemnitor's liquidity is a strong indication of the indemnitor's ability to complete the project, including future unanticipated expenses, change orders, and other sources of unexpected mechanic's lien problems. The indemnitor's most liquid asset is cash. But how much surplus cash should be available to the indemnitor for the Title Company to feel comfortable that the indemnitor can take care of any future mechanic's lien problems?

Theoretically, if the developer and lender have properly projected the costs of the project, then the amount of the loan funds allocated for hard costs should be sufficient to complete the project. However, an examination of troubled projects demonstrates the importance of the developer's financial ability to pay for cost overruns. Historically, if a project does encounter construction difficulties, then the parties can anticipate on average a 25% increase in the hard costs from the original budget.

FINANCIAL EXAMPLES

ABC CORPORATION Construction Loan \$25 million

ASSETS		LIABILITIES	
Cash	\$ 5,000,000	Short Term Debt	\$ 2,100,000,000
Apartments	3,000,000,000	Long Term Debt	3,130,000,000
Buildings	2,000,000,000	Total Liabilities	5,230,000,000
Equipment	500,000,000	SHAREHOLDERS EQUITY	
		275,000,000	
TOTAL	\$ 5,505,000,000	TOTAL	\$ 5,505,000,000

ABC just "squeaks" through on the liquidity side, and this alone would enable your Chief Title Officer to submit your high liability package. Yet, let's look at an intangible. While \$275 million in equity is substantial, compared to debt it is only 5%, meaning ABC is 95% in debt. For clarification, let's use the same percentages in a more common residential construction loan

MR. AND MRS. RARELY HAPPY FAMILY
Construction Loan \$1.25 million

ASSETS		LIABILITIES	
Cash	52,500	Credit Cards	200,000
Stocks and bonds	200,000	Loans	2,465,000
Vacant land	100,000	Total Liabilities	2,615,000
Residence	900,000		
Income Properties	1,500,000		
Income \$30,000 per month		EQUITY (assets minus liabilities)	137,500
TOTAL	\$2,752,500	TOTAL	\$2,752,500

Ok, not quite the same, but close. While stocks and bonds are not as liquid as cash, they can be converted. As nothing will be paid as a result of this construction loan, their total debt will be increased by the 1.25 million. While the 125% rule is a good starting point it is not the end of your analysis. An alternative may be to secure your indemnity with a deed of trust on the most debt free property they own, usually the residence. The financial statements will usually give you the addresses. Also, you may be required to have the contractor execute an indemnity. There may be some resistance, which should be communicated to your underwriting department.

The more loss of priority packages you receive the easier they become to analyze. Soon, you will not have to wait for underwriting to know if your package is acceptable.

PRIORITY INSPECTION PROCEDURES

The following sections are intended to provide general guidance only. Specific procedures and forms for your company should be obtained from your Chief Title Officer, Advisory Title Officer or underwriter.

Prior to providing mechanic's lien insurance, a priority inspection must be completed by the title company or insurer to determine if work has commenced for an improvement on the subject property.



Picture 1 "Break in priority"

THE priority of a recorded mechanic's lien will relate back to the date work first began on the work of improvement. The result is that later recorded mechanic's liens will have priority over a Deed of Trust recorded after the commencement of the work of improvement. The mechanic's lien claimant will be in a position to foreclose and establish the priority of the mechanic's lien against the lender's deed of trust. The reason for the priority inspection is to enable the title insurer to properly underwrite the mechanic's lien risk. The priority inspection often is the only evidence the Company will later have to show recording priority existed. Without proper evidence otherwise successful litigation can be lost.

California case law has established the "visible to the eye" test for a proper priority inspection.

THE California Courts use a "visibility test" for determining the date for the commencement of the work of improvement. Courts have said that the priority of a mechanic's lien starts the date work on the ground was "visible to the eye," "easily seen by everybody," and such that a person viewing the site could "readily see and recognize" the commencement of the work of improvement. IN title jargon, there is a "loss of priority" for the insured's deed of trust as against mechanics' liens where the work of improvement commenced prior to the recordation of the insured's deed of trust.

In order to have evidence, the title company or insurer sends an inspector to view the project prior to the recordation of the insured's deed of trust. If the title company or insurer is relying

upon the recordation of the deed of trust prior to the commencement of the work of improvement to establish priority of the deed of trust, then the inspector should also be present at the project site at the time of the recordation of the insured's deed of trust. Since evidence is needed that no work commenced prior to the recordation of the deed of trust it makes little sense to have evidence through an inspection dated a day before the recordation of the deed of trust.

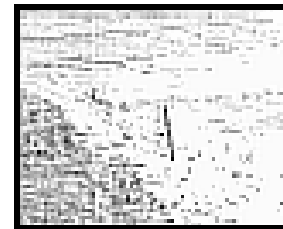
Picture 1 shows an obvious "loss of priority" for the properties on either side of the street. Signs of grading activity are present on both sides of the street. In addition, the framing and other "phase one" construction activity on the right side of the street may result in a break in priority for the other "vacant" future phases of the development. The inspector should use common sense during the priority inspection. If the inspector sees anything which might possibly be construed as the commencement of work, then the inspector should immediately notify the title company or insurer of the inspector's findings. Often it is contended that very obscure items such as borings, tests holes, power poles, fences, and construction trailers were the visible commencement of work. It is important to obtain and preserve evidence of the conditions at the property and to properly communicate what is observed so that underwriters can make proper decisions.

Number and Type of Photographs? Video?

A priority inspector should photograph all areas of the subject property. Usually the inspector will take at least three (3) photographs of the site. Also, it is necessary to absolutely establish priority. It is critical that the photos be date and time stamped. If a video camera is available, then the inspector should make a separate video tape of the project sitepanning all areas of the property with the video camera.



Picture 2



Picture 3

ARGUABLY the turning of just one shovel of dirt may result in a "loss of priority", assuming the resulting hole or pile of dirt is "easily seen by everybody." Within the view of the vacant lot in *picture 2* is a pile of dirt which confirms recent work on the property. In addition, the lot has been surveyed and graded, and may in fact be part of the phased development across the street. *Picture 3* shows a survey stake and signs of recent grading. The Inspector should not automatically assume some separate work of improvement exists for the grading work. Any survey or grading work should be brought to the attention

of the title company or insurer. The inspector should view the property as close as possible to look for visible signs of work.

The nature of the evidence which would trigger the commencement of a work of improvement would include the following:

1. Building materials or equipment deposited on the property, or if intended for use on the property, deposited on adjoining land, street, or alley.
2. Foundation Staking.
3. Surveying monuments.
4. Grading, excavating, test hole digging or depositing of fill.
5. Removal or destruction of buildings, trees, shrubs, weeds or similar evidence of the clearing of a building site.
6. Tract improvements, street work, installation of public utilities in progress, completed or accepted within the past 90 days.
7. Installation of pipes from a water meter into the property.
8. Erection of power poles, meter for electrical service, the presence of a workman's toilet.
9. Any evidence of repairs, remodeling, redecorating, additions to, or alterations of any kind to existing improvements.

The recording of a building contract does not of itself constitute the commencement of work for the purpose of determining priority between a security instrument and a claim of lien.



Picture 4

THEORETICALLY, if the inspector does not see any signs of work at the project site prior to the recordation of the insured's deed of trust, then the deed of trust should have priority over later recorded mechanics' liens. However, work in the vicinity of the building site has also been considered by the Courts in determining the commencement of the work of improvement. Therefore, to properly assist the title company or insurer with its evaluation of the priority issue, it is incumbent upon the inspector to inform the title company or insurer of the presence of nearby construction trailers or building supplies. A portable sanitation structure as shown in *picture 4* will often result in

mechanics' lien claimants contending that the deed of trust recording priority was broken by this visible sign of the commencement of work.

The Danger of Rehab Work

THE commencement of rehabilitation work on an existing building is typically not apparent from viewing the property from the street. Nevertheless, a loss of priority may occur as a result of the commencement of the rehabilitation work of improvement inside the existing structure. The priority inspector should request permission to inspect inside any existing structure to look for signs of rehab work. *Picture 5* shows turn of the century buildings in an apparently



Picture 5

abandoned condition. However, note the pieces of old and new lumber leaning against the outside brick walls which evidence ongoing rehabilitation work. *Picture 5* is an example of a major renovation project to save historical buildings.

Report Form

A priority inspector should submit a "priority inspection" report incorporating a set of claim tested questions which serve to focus the inspector's attention upon possible telltale signs of work. The form requires the inspector's signature on the statement describing the inspector's findings. A set of photographs or a video of the entire site must be submitted to the title company or insurer with the priority inspection report. The report and photographs or video are the only evidence in our file related to priority. Without this material the Company is without proof of recording priority and, years later, a lawsuit could be lost due to the failure to obtain and preserve this valuable demonstrative evidence.

CONCLUSION

THE inspector should apply the common sense expected of a good investigator while performing the priority inspection. The inspector should notify the title company or insurer of all possible signs of recent work. Sufficient notes, photographs or video should be made by the inspector to substantiate the inspector's findings. In the event a policy of title insurance is written on a "no loss of priority" basis and there is a subsequent mechanic's lien claim, then the inspector's report may very well be relied upon in defending the insured's priority position.

The Last Stages of the Construction Loan

The lender may request a 101.2 Endorsement (Notice of Completion recorded) or a 101.3 Endorsement (no Notice of Completion recorded) to release the final draw of the construction loan. If you determine the remaining lien period is 30 days or less (see Notice of Completion) you may consider what is commonly known as the 30 day waiver. This waiver is normally executed by the general contractor, if they are the last possible claimant. If the mechanic's lien claimant is required to execute a waiver and release in exchange for, or in order to induce payment of, a final payment and the claimant asserts in the waiver it has, in fact, been paid the final payment, the waiver and release shall follow substantially the following form. See California Civil Code §§ 3262(3) et seq:

**UNCONDITIONAL WAIVER AND RELEASE
UPON FINAL PAYMENT**

NOTICE: THIS DOCUMENT WAIVES RIGHTS UNCONDITIONALLY AND STATES THAT YOU HAVE BEEN PAID FOR GIVING UP THOSE RIGHTS. THIS DOCUMENT IS ENFORCEABLE AGAINST YOU IF YOU SIGN IT, EVEN IF YOU HAVE NOT BEEN PAID. IF YOU HAVE NOT BEEN PAID, USE A CONDITIONAL RELEASE FORM.

The undersigned has been paid in full for all labor, services, equipment or material furnished

to _____ on the job of _____
YOUR CUSTOMER OWNER

located at _____ and does hereby waive and release any
JOB DESCRIPTION

right to a mechanic's lien, stop notice, or any right against a labor and material bond on the job, except for disputed claims for extra work in the amount of \$ _____.

Dated: _____
COMPANY NAME

By: _____
TITLE

There are other waivers contained in Civil Code section 3262, but none have the finality of the UNCONDITIONAL WAIVER AND RELEASE UPON FINAL PAYMENT above.

Some of these are:

- CONDITIONAL WAIVER AND RELEASE UPON PROGRESS PAYMENT
- UNCONDITIONAL WAIVER AND RELEASE UPON PROGRESS PAYMENT
- CONDITIONAL WAIVER AND RELEASE UPON FINAL PAYMENT

An evidence of title issued in reliance on a waiver of mechanics' lien rights should be approved by Management.

RECORDING REQUESTED BY

AND WHEN RECORDED MAIL TO

RELEASE OF CLAIM OF MECHANIC'S LIEN

The Mechanic's Lien claimed by _____
(Name of person or firm exactly as it appears on lien)

against _____
(Owner or purported owner as named in lien)

upon the following described real property in the City of _____,
County of _____, State of _____,

Legal Description: _____

with the following street address: _____

is hereby released.

Notice of Lien recorded as Instrument No. _____ on _____, in
Book _____ Page _____, official records of _____ County,
California, is hereby satisfied and released.

Dated: _____

NAME: _____
(As it appears on lien)

BY: _____

CERTIFICATE OF ACKNOWLEDGEMENT OF NOTARY PUBLIC

STATE OF CALIFORNIA,)
COUNTY OF _____)

On _____ before me, _____, a notary public in and for said County and State, personally appeared _____ personally known to me (or proved to me on the basis of satisfactory evidence) to be the person(s) whose name(s) is/are subscribed to the within instrument and acknowledged to me that he/she/they executed the same in his/her/their authorized capacity(ies), and that by his/her/their signature(s) on the instrument the person(s), or the entity upon behalf of which the person(s), acted, executed the instrument. WITNESS my hand and official seal.

(Signature of Notary Public)