

What Wisconsin Lenders Should Know About Construction Liens

Jul 15 2014

Posted By: Anne E. Wal & David I. Cisar

Practice Area: Banking and Commercial Finance & Construction Law and Litigation & Real Estate

Construction liens can be complicated and are not regularly encountered by lenders. This Update will address questions we are frequently asked by Wisconsin-based lenders about what to do when construction lien notices are received or construction liens are filed.

Typical scenario: A lender makes a construction loan secured by a mortgage against the property that is being improved. After the construction loan is made, the borrower forwards to the lender copies of notices that the borrower received from the prime contractor. Should the lender be concerned? Do the notices impact the lender's mortgage?

What is a construction lien? A construction lien is an encumbrance on real property under construction, or that has been constructed, filed against real property by a party who has performed services or supplied materials to improve that property and who has not been paid.

Who has the right to file a construction lien? Persons who perform or provide any work, labor, service, materials, plans, or specifications, used or consumed for the improvement of land and who comply with the requirements of Wisconsin's Construction Lien Law (Chapter 779 of the Wisconsin Statutes) may file and enforce construction liens. Persons commonly hired to provide design and construction services, including contractors, construction managers, engineers, architects, designers and decorators, as well as the suppliers of construction materials, all have lien rights, whether retained directly by the property owner or the general contractor.

Can a party waive its lien rights? A party (or "lien claimant") can sign a document to partially or wholly waive its lien rights. During the construction process, a lien claimant will typically provide a partial lien waiver to a lender (or a title company on behalf of a lender) as a prerequisite to partial payment. Final lien waivers are typically required and obtained upon receipt of final payment. Construction lenders should note the following about lien waivers:

- Lenders should require partial lien waivers from all persons who have performed or provided any services or materials since the date they were last paid.
- Lien waivers should be carefully examined to verify that the party providing the lien waiver is the actual party who performed the work or provided the materials.
- Lenders should also require a full and final lien waiver waiving all lien rights in exchange for final payment.
- Partial lien waivers should waive all lien rights for labor and materials provided through the date stated in an application for payment and should not be based on an amount paid.
- Lenders should not accept waivers labeled "conditional" or that indicate the waiver is only effective **if** payment is received; such waivers leave factual issues to fight about, and are useless if a payment intermediary (e.g., the prime contractor) absconds with the funds instead of paying subcontractors or suppliers.

How does a lender know if a property is encumbered by a construction lien? Unlike other types of liens against real property, which are recorded with the register of deeds, a construction lien is filed with the clerk of circuit court. When a lender desires to identify all encumbrances affecting real property, a lender should order a title commitment or a letter report from a reputable title company. A title commitment will include the results of searches of the records of the register of deeds and the clerk of circuit court. If a letter report is requested, the lender must specify that it wants construction liens of record included in the letter report (without a specific request, a letter report will only provide limited information from records of the register of deeds).

When does a construction lien have priority over other encumbrances? With the exceptions described below, a construction lien takes its priority from the date of visible commencement of work. For new construction, "visible commencement" occurs no earlier than substantial excavation for the foundations or footings. In the case of an addition to an existing structure, "visible commencement" is considered to be the earlier of the beginning of substantial excavation or when the existing structure is readied to receive the addition. All construction liens share their priority from the same "visible commencement" date, regardless of when the particular work was done or materials provided.

What are the exceptions to construction lien priority? Mortgages recorded and executed to certain lenders have priority over a construction lien unless the construction lien is actually filed before the mortgage is recorded. These lenders (referred to in this *Update* as "Preferred Lenders") include:

- State and national banks, state and federally chartered credit unions, savings and loan associations and savings banks; and
- Most governmental entities (including local, state, and national governments and their agencies and departments).

A Preferred Lender has priority for advances of funds made over a period of time to a borrower to construct improvements to land under a recorded mortgage, provided it says "Construction Mortgage" on its first page. The advance of funds after the Construction Mortgage is recorded has the same priority as the recorded Construction Mortgage. Tax and environmental liens take priority over all liens, including construction liens.

Will a filed construction lien affect the lender's mortgage priority? It depends. If the construction lien was filed before the lender's mortgage was recorded, then the construction lien has priority over the lender's mortgage. If the construction lien was filed after the lender's mortgage was recorded, and the lender is not a Preferred Lender, then the construction lien likely has priority over the mortgage if visible commencement preceded the date of recording. If the construction lien was filed after the lender's mortgage was recorded, and the lender is a Preferred Lender, then the lender's mortgage should be given priority over the construction lien even if visible commencement preceded the recording of the mortgage. A mortgage that is given to secure construction advances should say, on its first page, that it is a Construction Mortgage.

Does a borrower's receipt of a "Notice of Lien Rights" have any effect on the priority of the lender's mortgage? No. A Notice of Lien Rights is required to be delivered under the Construction Lien Law by those parties who wish to preserve their lien rights for a residential project with no more than four units. No action is necessary to preserve the mortgage lender's priority. It is for the lender's information only and is typically used to identify the parties (the contractor, subcontractors and others) working on or supplying materials to a project and who will be requesting payment.

Some projects have payment bonds. Does a lender have different duties for bonded projects? On bonded projects (usually public projects), instead of having the right to file a lien against the real estate being improved, any person that performs labor or services or supplies materials at the request of the contractor has a lien on the money to be paid to the contractor. In order to implement this lien, the claimant, before payment is made to the contractor by the borrower (the owner of the property), must serve written notice of its claim on the borrower and any lender furnishing funds for the project. The borrower and lender are then responsible for ensuring that a sufficient amount is withheld to pay the claim. If the contractor who hired the lien claimant admits the claim or fails to dispute it, then the borrower and lender must pay the amount demanded to the claimant and may then offset the amount paid against any amount still owed to the contractor. If the borrower or lender does not withhold sufficient funds to pay the claim, then the borrower or lender (whichever failed to withhold the funds) is liable to the claimant for the damages resulting from this failure.

Wisconsin law provides significant protections for Preferred Lenders by giving their mortgages priority over construction liens. Construction liens can take priority over a lender's mortgage lien, but only in certain circumstances. Lenders can best protect themselves by first obtaining a lender's title insurance policy that deletes the exception for construction liens and then using a reputable title agency to disburse the loan proceeds and collect the lien waivers in exchange for payment. If construction liens arise during the course of construction, the lender should contact the title company and engage its own attorney to discuss options.

von Briesen & Roper Legal Update is a periodic publication of von Briesen & Roper, s.c. It is intended for general information purposes for the community and highlights recent changes and developments in the legal area. This publication does not constitute legal advice, and the reader should consult legal counsel to determine how this information applies to any specific situation.