

Mechanic's Liens in Virginia

I. Why Mechanic's liens are such a problem in Virginia

In Virginia, as in most states, priority of a recorded deed, deed of trust, judgment, etc. is determined as of the time of recordation. If a deed of trust is recorded prior to a judgment, another deed of trust, or another deed, that deed of trust has **priority**, "first in time, first in right." In the event of a dispute, that deed of trust should be first in line to be paid.

Mechanic's liens provide an exception to the chronological priority filing status of documents when a laborer/subcontractor (mechanic) has provided labor, or a supplier of tangible person property (materialman) has provided materials for **new construction which improves the real estate**. The labor and supplies add value to the real estate, therefore the laborers and supplies are given special consideration in the form of a mechanics' and materialmen's lien on the real estate. Once timely filed, the mechanic's lien will be superior to any deed, deed of trust, or other document recorded before the mechanic's lien. In Virginia the time for filing a mechanic's lien notice is 90 days after the end of the month in which labor or supplies were furnished to the building site, or 90 days after the project is completed, whichever comes first. This translates to 123 days for convenience in the title industry.

A mechanic's lien is a "hidden lien" since it can be recorded AFTER a deed or deed of trust has been recorded, or a construction loan title policy has been updated, yet will take priority if enforced. Lenders want to be insured they have priority over subsequently filed mechanic's liens, that the title insurance policy will give coverage for any mechanic's lien problem. Lenders require affirmative coverage against mechanics' liens.

In Virginia a mechanic's lien is enforced, after recordation of the lien, by:

a. Filing suit within 6 months of recordation of the notice; or within 60 days of the termination of the work; or within 60 days of the completion of the project, whichever occurs last;

b. Obtaining a judgment against the owner of the real estate; and

c. Asking the court to order the sale of the real estate to satisfy the lien.

The mechanic's lien, now a judgment with the real estate being sold to satisfy the lien, would be paid prior to any other lien or deed of trust, and would take priority over a deed of record, depending upon the specific details of a transaction.

To prevent loss, affirmative mechanic's lien coverage for lenders will not be given unless our guidelines are strictly followed by agents. Rules differ for residential and commercial transactions.

II. Residential Construction and the Mechanic's Lien Agent (MLA)

(one and two dwelling units, including individual condominium & townhouse units)

To protect lenders, title insurance companies, and themselves, owners on residential construction projects (consisting of one and two dwelling units, including individual condominium & townhouse units) may list a **mechanics' lien agent (MLA)** on the building permit so that subcontractors and suppliers working on the project may give notice and preserve their right to file a lien. It allows the settlement agent to know who is providing services and supplies on a job site, so that lien waivers may be collected. Just as important, if a subcontractor or supplier fails to give proper notice to the MLA, he cannot file a mechanic's lien, and must sue for breach of contract to collect any monies owed.

<http://leg1.state.va.us/cgi-bin/legp504.exe?000+cod+43-4.01>

1. Who may serve as an MLA?

- a. an attorney at law licensed to practice in the Commonwealth, or
- b. a title insurance company authorized to write title insurance in the Commonwealth, or one of its subsidiaries, or licensed title insurance agents, or
- c. a financial institution authorized to accept deposits and to hold itself out to the public as engaged in the banking or savings institution business in the Commonwealth or a service corporation, subsidiary or affiliate of such financial institution.
- d. NOTE: Any such person may perform mechanics' lien agent services as any legal entity.

2. When and how is an MLA properly appointed?

An MLA may only be appointed with the construction of a "one- or two-family residential dwelling unit". The appointment must be made in writing by the owner(s) of the property. Effective July 1, 2010 an MLA may be appointed by amending the building permit at any time in the constructions process. The designated MLA has to agree to serve, but no longer has to agree *in writing* to act as MLA. The building permit must list the name, address and phone number of the lien agent.

3. How do subcontractors and suppliers "know" whether there is an MLA?

The building permit, containing name, address and phone number of MLA, is to be "... conspicuously and continuously **posted** on the property for which the permit is issued until all work is completed on the property."

If the building permit is not posted on the construction site, the sub or supplier must contact the building permit office to determine if an MLA is appointed.

4. What happens if construction has begun before the building permit is posted?

Virginia Code requires "The permit shall be posted on the property before any labor is performed or any material furnished on the property for which the building permit is issued."

If the building permit is not posted on the construction site, the sub or supplier must contact the building permit office to determine if an MLA is appointed.

5. How does a sub or supplier give notice to the MLA?

“A return receipt or other receipt showing delivery of the notice to the addressee or written evidence that such notice was delivered by the postal service or other carrier to but not accepted by the address shall be prima facie evidence of receipt.”

The notice shall contain (i) the name, mailing address and telephone number of the person sending such notice, (ii) the building permit number on the building permit, (iii) a description of the property as shown on the building permit, and (iv) a statement that the person filing such notice seeks payment for labor performed or material furnished.”

From a title insurance viewpoint, any notice, or attempted notice, even if defective should be reported to the title agent by the MLA and lien waivers obtained from the sub or supplier giving such notice.

6. When must a sub or supplier give notice to the MLA?

Notice must be given to the MLA within 30 days of beginning work on the project, or if no permit is posted at the time they begin work, within 30 days of the building permit being posted.

If the building permit is amended to add an MLA, a sub or supplier must give notice within 30 days of the amended building permit being posted.

If notice is given after the initial 30 days someone is on the job, it only applies to amounts due after notice was given.

7. What is the effect of a sub or supplier giving notice to the MLA?

Giving notice preserves his right to file a mechanic’s lien if he is not paid. If notice is given after the initial 30 days someone is on the job, it only applies to amounts due after notice was given.

It also informs the title company that there is a sub or supplier that expects to be paid from each draw until there is a zero balance on their account, i.e., until they are paid in full for the work they agreed to do on the job in question. Therefore the title agent will require that the MLA certify, at each draw, as to who has given notice AND require a lien waiver from all those who have given notice, even if the notice is defective. The title agent MUST receive a lien waiver from each person who has given notice ANY TIME during the construction process, until a final, zero balance lien waiver has been received.

8. What is the duty of the MLA?

“Unless otherwise agreed in writing, the only duties of the mechanics’ lien agent shall be to receive notices delivered to him ... and to provide any notice upon request to a settlement agent ...”

The MLA *may* agree to be disbursing agent for the construction project, but generally such function is performed by the lender, or by the settlement agent. It makes sense for the settlement agent to act as MLA and as disbursement agent to maintain contact and serve their client base.

9. Who issues draw endorsements to the lender?

The settlement agent has title updated and issues draw endorsements, when requested by the lender. The settlement agent must require the abstractor to search “loose” documents that may not yet be indexed to make sure the update reflects the disbursement date.

III. Residential Construction without an MLA appointed

Although MLA rules have been part of the Virginia Code since 1992, some builders and many individual homeowners still are unaware of the benefits of appointing an MLA, or are resistant to adding a MLA to the building permit. As you saw above, since July 1, 2010 it has been possible to amend building permits to add an MLA after construction has begun. The problem for title insurance agents is that we cannot tell who has been working on the construction as a subcontractor, nor who has been a supplier, prior to the MLA being added to the permit. Therefore, we don't know who needs to have been paid, who needs to give lien waivers. The builder must provide lien waivers for all who have worked on the job or supplied materials prior to the time the MLA was listed on the building permit. The lender / appraiser may be able to assist with letting the title agent know at what state of completion the property is.

Often this situation arises when someone wants to build without obtaining a loan, then decides to obtain the loan before the construction is completed.

IV. Applicable to all residential transactions

1. **When does a sub or supplier give a lien waiver?**

“Any right to file or enforce any mechanic’s lien granted hereunder may be waived in whole or in part at any time by any person entitled to such lien, except that a subcontractor, lower-tier subcontractor, or material supplier may not waive or diminish his lien rights in a contract in advance of furnishing any labor, services, or materials.” Va Code §43-3 as of July 1, 2015.

Typically title agents will receive lien waivers one draw after a disbursement. The owner/contractor has to receive funds from a lender before they can pay the subs and suppliers. In exchange for payment they obtain a partial lien waiver, until the work of a specific sub or supplier is completed as to a particular job. At the time of completion and payment, a final lien waiver is signed.

The “one draw behind” concept works until the final draw. At that time either the sub/supplier provides a final lien waiver prior to the final disbursement, or disbursement is made directly to the sub/supplier at the time of final draw in exchange for the lien waiver, or some other system is worked out between the lender, builder and title company.

It always makes sense to inquire of anyone who has given notice whether or not the contractor is making payments on time, or whether he is in arrears.

2. **What is an Affidavit of Payment?**

Virginia Code §43-13.2 and §43-13.3 require owners of real estate to provide an Affidavit of Payment. §43-13.2 addresses when the owner is also “... either a developer of such property, a contractor in connection with the development or improvement of such property or a contractor or subcontractor furnishing labor or material in connection with the development or improvement of such property...” The affidavit must list all persons owed money at the time of outsale, OR state that all persons have been paid.. Failure to be accurate on this affidavit is punishable as a Class 5 felony.

Often §43-13.2 doesn't apply because the owner of the land is one entity and the developer and/or builder is another entity, owned by the same principals, but legally distinct entities.

§43-13.3 applies to an owner who is not in the business as a developer. The affidavit is the same, but the penalty is a Class 3 misdemeanor.

If an Affidavit of Payment does not apply, Old Republic requires a Final Affidavit and Agreement to be signed by both the builder and the owner.

V. Commercial Construction (any non- MLA construction)

Requirements for commercial construction mechanic's lien approval, for any construction transaction where an MLA is not appointed, is significantly more involved. Each transaction has to be analyzed to determine the risk involved in the transaction, not just the ML risk, but the risk the project will be completed with the funds pledged to the construction.

Most builders/developers/owners complain about having to provide financial information of their company, or individually, if they are serving as guarantors of the loan, and guarantors of the ML indemnity agreement with Old Republic. However, how can we tell whether they have the financial strength to back up their indemnity promise if we don't have the information?

Not only do we have to review financials, but we also have to look at the job itself, to see what the project is, to look at the projected list of subs and suppliers, so we might be aware of the types of lien waivers to expect, from whom to expect them, and at what stage of construction to expect them.

The ALTA 32 series endorsements are available for use in situations where the priority of the lien of an insured mortgage or deed of trust does not have absolute priority over potential mechanic's liens and where you will be reviewing draw requests and disbursement records whether or not you are acting as the disbursing agent. The coverage afforded by the ALTA 32 series is significantly more limiting in the lien coverage provided than any other previously issued ALTA products as these endorsements are intended to avoid the potential of having a Loan Policy operate as a payment bond.

If you are not acting as the disbursing agent or are not otherwise reviewing draw requests and disbursement records then none of the ALTA 32 series endorsements should be used. In most cases in Virginia you will be updating title and issuing policy endorsements, so the ALTA 32 series is appropriate.

ALTA 32.06 (Loss of Priority Construction Loans) - The ALTA 32-06 endorsement provides coverage **only** to the extent that the charges for the services and/or materials rendered were designated for payment in the documents supporting a Construction Loan Advance disbursed by or on behalf of the Insured on or before the Date of Coverage.

This endorsement does not require the Company to disburse the construction funds.

This endorsement is recommended for use in most Virginia transactions.

ALTA 32.1-06 (Construction Loan – Loss of Priority – Direct Payment) - The ALTA 32.1-06 endorsement provides coverage **only** to the extent that direct payments to the labor and material suppliers have been made by the Company or by the Insured with the Company's written approval. This endorsement does require that construction disbursements be made by the Company either making direct payments to labor and material suppliers or by specifically authorizing, in writing, that such a payment be made.

ALTA 32.2-06 (Construction Loan – Loss of Priority – Insured's Direct Payment) - The ALTA 32.2-06 endorsement provides coverage **only** to the extent that direct payments to the labor and material suppliers has been made by the Insured or on the Insured's behalf on or before the Date of Coverage. It does not require the Company to disburse the construction funds.

ALTA 33 – Disbursement Endorsement - This endorsement, which acts as a draw endorsement for construction disbursements and draws, is to be used solely in connection with the ALTA 32-06, 32.1-06, or 32.2-06. The endorsement provides for a change to the Date of Coverage as defined in the ALTA 32 series, but does not change the Date of Policy or any other endorsements issued in connection with the policy. It also requires the insertion of any additional exceptions resulting from the title search done in connection with the issuance of the endorsement.

VI. Identifying the Type of Transaction

Which requirements and exceptions are used depends on the transaction to be insured.

Types of transactions

A. New Residential Construction – not yet completed (beginning or partially completed)

1. MLA appointed at the beginning of, or prior to construction
2. MLA appointed after the beginning of construction
3. no MLA yet appointed

B. Residential Outsale (construction completed)

1. MLA appointed
2. no MLA appointed individual owner/builder
3. no MLA appointed professional builder

C. Commercial construction (everything except for one and two dwelling units, including individual condominium & townhouse units)

1. During Construction phase
2. Outsale – Construction complete

Sample Requirements and Exceptions for each transaction type are attached.

Forms are attached.

SAMPLE LANGUAGE

New Residential Construction – not yet completed (beginning or partially completed)

All three circumstances are covered with one set of requirements and exceptions.

1. MLA appointed at the beginning of, or prior to construction
2. MLA appointed after the beginning of construction
3. no MLA yet appointed

A. Residential New Construction, MLA appointed; or is to be appointed

(building permit [either initial or amended] lists an MLA)

Only applies to one- or two- family residential dwelling units. Other properties must follow the Commercial Requirements.

Schedule B-1 Requirements (Residential New Construction, MLA appointed), (during construction)

The following are required for mechanic's lien coverage:

- (1) Designation of MLA form signed by owners of land and accepted by the MLA. **ORT ML 1.10 or ML 1A.10**
- (2) Building permit must designate MLA: name, address, phone number. A copy must be provided to the title agent prior to first endorsement issued after MLA was appointed.
- (3) If an MLA was not appointed prior to construction beginning, the owner must amend the building permit to add an MLA, and provide a copy of the issued permit to the Company. Lien waivers from all who worked on the job, or supplied goods, prior to the issuance of the amended building permit must be provided. **ORT ML 3.10**
Owner and General Contractor must sign an affidavit regarding work done prior to issuance of the amended building permit. **ORT ML 4A.10**
- (4) Indemnity Agreement must be signed by all Owners and General Contractors. **ORT ML 8.10**
- (5) At each draw, title must be updated.
- (6) At each draw, MLA must certify as to who has given notice. **ORT ML 2.10**
- (7) At each draw, lien waivers must be received from all who gave notice to the MLA. The lien waivers may follow one draw behind. **ORT ML 3.10**
- (8) Receipt by the company of an Affidavit of Payment (**ORT ML 6.10**) or a Final Affidavit & Agreement (**ORT ML 7.10**) stating all contractors, subcontractors, and suppliers have been paid, or listing amounts still due. Lien Waivers must be received from all payees listed on the Affidavit, if any, at the time of final disbursement. **ORT ML 3.10**

Schedule B-2 Exceptions (Residential New Construction, MLA appointed)

Add following Affirmative Coverage for Mechanics Liens to Schedule B-2:

- # **AS TO LOAN POLICY ONLY:** Possible unfiled mechanics's and materialmen's liens, but this policy provides affirmative lien insurance as set forth herein.
- a. ALTA 32-06 endorsement will be attached to the loan policy. Any inconsistency between terms of the ALTA 32-06 endorsement and the balance of this pending disbursement language is reconciled in favor of the ALTA 32-06.
 - b. This policy insures only to the extent of the amount actually disbursed, but

- increases as each disbursement is made in good faith and without knowledge of any defects in, or objections to, the title, up to the face amount of the policy. Said increase in the company's liability for mechanics liens is conditioned upon receipt by the company, at the time of each disbursement, releases of liens from all those persons giving notice to the mechanics lien agent on a one draw behind basis.
- c. At the time of each disbursement of loan proceeds, the title must be updated to such time for possible liens or objections intervening between the original effective date and the date of such disbursement.
 - d. Anything contained in the policy and this endorsement to the contrary notwithstanding, this policy does not guarantee the completion of improvements, their compliance with building plans and specification, nor the sufficiency of funds for the completion thereof.
 - e. When the Policy involves a credit line deed of trust, the Company will charge additional premium when the deed of trust is modified to add new property or to increase the total amount of the loan, as well as when the aggregate face amount of the policy has been exceeded. A draw endorsement may not be issued until payment is received.

AS TO OWNER'S POLICY ONLY: Pending completion of the contemplated improvements to be erected on the insured premises, liability under this policy is limited to the purchase price paid for the land. Subject to a continuation of the examination of the title to the land, for any liens or objections to title intervening between the effective date hereof and the time when the proposed improvements have been completed, and conditions upon compliance with any requirements of title necessitated as a result of the erection of the improvements, and upon payment of any additional premium charges due, the amount of this policy is increased, up to the face amount of the policy, to include the value of the completed improvements. This is not a guarantee of completion.

SAMPLE LANGUAGE

B. Residential Construction – Outsale (Construction complete)

When you are insuring property once construction is complete, whether it is a conversion from a construction to permanent loan, or a sale to a third party, first determine whether or not an MLA was appointed. Requirements are different depending on the circumstances involving the transaction. If the Requirements are met, no exception for mechanic's liens will appear in the Policy.

1. If an MLA was appointed require in Schedule B-1:

For mechanic's lien coverage, when an MLA was appointed, provide the following.

Additional requirements may be made after review.

- a. a copy of the building permit, showing MLA's name, address & phone number
- b. a copy of the appointment/Designation of the MLA, signed and dated by the Owners and MLA's acceptance **ORT ML 1.10 or ML 1A.10**
- c. certification from the MLA, with copies of all notices received **ORT ML 2.10**
- d. final affidavit and agreement from the Owner and Builder **ORT ML 7.10**
- e. Affidavit of Payment from the Owner (Va Code §43-13.2 or §43-13.3) **ORT ML 6.10**
- f. lien waivers from all who gave notice AND from any listed on the ORT Final Affidavit and Agreement and/or the statutory Affidavit of Payment **ORT ML 3.10**
- g. Copy of Certificate of Occupancy

2. If no MLA was appointed AND you have an individual Owner/Builder (not a professional builder) require in Schedule B-1:

For mechanic's lien coverage for a lender, when an MLA was NOT appointed and the owner is not a professional builder, Owner intends to reside on the premises, and is obtaining permanent financing, provide the following. Additional requirements may be made after review.

- a. ORT Final Affidavit and Agreement from the Owner/Builder **ORT ML 7.10**
- b. Affidavit of Payment from the owner (Va Code §43-13.3) **ORT ML 6.10**
- c. lien waivers form all listed on the Affidavit of Payment **ORT ML 3.10**
- d. Copy of Certificate of Occupancy

NOTE: These requirements apply when Owner/Builder has built the improvements for his personal use.

3. If no MLA was appointed AND you have a professional Builder require in Schedule B-1:

For mechanic's lien coverage for a lender, when an MLA was NOT appointed and the owner is a professional builder, or an individual owner/builder who is selling the real estate within 123 days after construction is complete, provide the following. Additional requirements may be made after review.

- a. Builder to provide a list of all subs and suppliers
- b. lien waivers from each sub and supplier, including those listed in the ORT

Final Affidavit and Agreement and/or the statutory Affidavit of Payment
ORT ML 3.10

- c. **ORT Final Affidavit and Agreement from the Owner and Builder ORT ML 7.10**
- d. Affidavit of Payment from the owner, (Va Code §43-13.2 or §43-13.3)
ORT ML 6.10
- e. **ORT Indemnity Agreement ORT ML 8.10**
- f. Copy of Certificate of Occupancy

Sample Language

Commercial construction (everything except for one and two dwelling units, including individual condominium & townhouse units)

1. During Construction phase
2. Outsale – Construction complete

C. Commercial construction – during construction

When the MLA provisions do not apply, whether because the property is not a one or two dwelling unit or because it is commercial real estate:

Schedule B-1 commercial requirements:

1. Receipt of the following information so that the mechanic's lien risk can be analyzed by the Company. Additional requirements or exceptions may be made after review. Review does not guarantee approval of affirmative mechanic's lien coverage for the lender.
 - a. Project budget with sources and uses of funds. A job/cost breakdown of the project shall be provided, with a estimate of what tasks shall be performed at each draw, the dollar amount budgeted for each task, and the name of the subcontractor or supplier that is estimated to provide the service or supplies.
 - b. Copy of the construction contract with builder
 - c. Copy of the loan commitment, including without limitation the construction draw schedule or formula
 - d. Current financial statements (audited statements, if available) for the borrowers and all guarantors of the loan and other evidence requested by and satisfactory to the Company, as to their creditworthiness **Note: # d is waived if lender accepts an ATLA 32-06 construction endorsement.**
2. If mechanics' lien coverage is approved, receipt of a fully executed Owner's and Contractor's Affidavit and Indemnity signed by all Owners, Contractors and Guarantors. NOTE: If a loan is involved, any person required to serve as a personal guarantor on the loan shall be required to serve as a personal guarantor on the Indemnity Agreement. **ML 8.10**
3. If draw endorsements are required by the lender during the construction process, then prior to each draw, the following are required:
 - a. Title to be updated. Timely notice shall be given to the Company to allow sufficient time to update the title in the court records and to note any exceptions to coverage for matters discovered in the title update.
 - b. Receipt of an interim affidavit fully executed by the Owner and Builder at each draw. **ORT ML 4.10**
 - c. Statement (invoice) of parties to be paid from current draw, and
 - d. Lien waivers shall be provided for all persons paid from the prior draw, until the last draw, at which time lien waivers shall be needed from all subs and suppliers. **ORT ML 3.10 Note: waived if lender accepts an ATLA 32-06 construction endorsement.**

- e. Final Indemnity Agreement to be signed by Owner and Builder at final draw.
ORT ML 7.10

- 4. Prior to the issuance of the final policy or the endorsement extending full coverage on the final policy, the Company must receive in satisfactory form and substance:
 - a) Final Waivers of Mechanic's Liens on forms supplied or approved by the Company for all work performed and materials supplied on the job **ORT ML 3.10**
 - b) A complete and accurate copy of the occupancy permit or equivalent duly issued by the appropriate governmental authority
 - c) The written acknowledgement by the Borrower and the General Contractor that all work has been completed in accordance with the terms of the construction contract (or separate provision has been made for the escrow of any funds not yet paid, pursuant to a written escrow agreement approved by the Company) and that all sums due and owing are paid to or into an escrow account and have been received by the General Contractor or the escrow agent. **ORT ML 7.10**

Commercial Construction Exceptions:

Upon satisfaction of the requirements, the following endorsement will appear in the Loan Policy:

As to Loan Policy only: ALTA 32-06 endorsement will be attached to the loan policy. NOTE: At the time of each advance, the Company must be in receipt of partial releases of liens in form and amount satisfactory to the Company, prior to the Insured's release of proceeds to the Borrower, or a signed interim affidavit from the owner.

As to Loan Policy only: When the Policy involves a credit line deed of trust, the Company will charge additional premium when the deed of trust is modified to add new property or to increase the total amount of the loan, as well as when the aggregate face amount of the policy has been exceeded. A draw endorsement may not be issued until payment is received.

As to Owner's Policy only: Pending completion of the contemplated improvements to be erected on the insured premises, liability under this policy is limited to the purchase price paid for the land. Subject to a continuation of the examination of the title to the land, for any liens or objections to title intervening between the effective date hereof and the time when the proposed improvements have been completed, and conditions upon compliance with any requirements of title necessitated as a result of the erection of the improvements, and upon payment of any additional premium charges due, the amount of this policy is

increased, up to the face amount of the policy, to include the value of the completed improvements. This is not a guarantee of completion.

D. Commercial construction – Outsale/refinance (Construction complete)

When the MLA provisions do not apply, whether because the property is not a one or two dwelling unit or because it is commercial real estate:

Schedule B-1 commercial requirements :

For mechanic's lien coverage for a lender within 123 days after construction is complete, provide the following. Additional requirements may be made after review.

- a. Builder to provide a list of all subs and suppliers
- b. Lien waivers from each sub and supplier, including those listed in the ORT Final Affidavit and Agreement **ORT ML 3.10**
- c. ORT Final Affidavit and Agreement from the Owner and Builder **ORT ML 7.10**
- d. ORT Indemnity Agreement **ORT ML 8.10**
- e. Copy of Certificate of Occupancy
- f. If a lender was involved during construction, a copy of final inspection report