



HIDDEN LIENS EXPOSED

Uncovering the controversy behind North Carolina's new law.

By Sarah Miranda and Chris Salyer, Hutchens, Senter, Kellam & Pettit, P.A.

New legislation has been enacted in North Carolina that brings substantial change to the state's mechanic and materialman lien law. The changes were designed to address the increasing "hidden lien" controversy and are slated to take effect April 1.

Under existing North Carolina law, a contractor, subcontractor, or material supplier may file a claim of lien on real property within 120 days of completion of the work and may file suit to perfect and enforce the lien within 180 days of the day of last completion. The lien will then relate back to the first furnishing of labor, services, or materials by the claimant. Thus, any mortgage lender making a loan during this period, or even an innocent purchaser of a property, will take subject to the lien, which has retroactive priority status. As there is no requirement that the lien be of public record at the time the property is sold, it makes it quite difficult for closing attorneys, lenders, and title insurance companies to identify these "hidden liens."

How does a lien come about in a residential construction project, and how does it give rise to the "hidden lien" feature? Say a builder buys a lot and starts constructing a house. He most likely obtained a construction loan to build said house and at the start of the project is paying the contractors he has hired, such as the concrete company for the foundation or the grading company to clear the lot and prepare it for building. As the project progresses, the builder finds himself searching for cash and begins robbing Peter to pay Paul, most likely from a draw from the construction loan. As empty promises by the builder come and go, the contractors start

getting nervous about getting paid and start considering whether a claim of lien should be filed with the court. Once the unpaid contractors get word that the house has closed and disbursed, the unpaid contractors start filing their liens and the lawsuits if needed in order to perfect the lien. A properly perfected lien will relate back to the first date of delivery or work performed. Therefore, a properly perfected lien is going to have priority over the new owner as well as the mortgage lender even though the lender holds a purchase money deed of trust. At the time the closing attorney updates title, it is possible no liens have been filed. The contractors still have lien rights at this time, which gives rise to the hidden lien since there is no claim of lien on record. Once the new owner or mortgage lender gets notice of the claim of lien, a claim is filed with the title company, which oftentimes results in a title company writing a check to satisfy the lien.

As a result of increasing claim litigation over these "hidden liens," many title insurance companies took the position last year that they would no longer issue new construction coverage in North Carolina on their title policies. Realizing the drastic effect this would have on North Carolina's construction industry as well as anyone involved in the closing process, the North Carolina legislature enacted new legislation in July 2012 that overhauled the state's existing lien law. Modeled after Virginia's lien law, one of the most significant changes North Carolina adopted is the requirement that a property owner designate a lien agent who must be placed on notice by any potential lien claimant.

Starting April 1, all private construction projects valued at \$30,000 or more will require the designation of a lien agent obtained from a list of title insurance companies or insurance agents maintained by the North Carolina Department of Insurance. In order to preserve rights, the lien claimant must serve notice on the lien agent within 15 days after first furnishing labor or materials to the project. The initial notice is not a lien, but merely an announcement that a contractor, subcontractor, or material supplier started work and reserves the right to file a lien at a later date. However, do not be confused. The lien agent is not an agent of the owner of the property and the notice by itself is not sufficient to claim a lien on the subject property. Therefore, in addition to giving the designated lien agent notice, effective January 1, a potential lien claimant must also file and serve notice on the owner of the property in order to perfect a claim of lien. (Remember, prior law did not require that the claim of lien be served in order to be properly perfected.)

The new law gives absolute protection to lien claimants who give notice to the lien agent within 15 days of starting work. If a lien claimant fails to file the requisite notice, and the property is mortgaged or refinanced before a claimant files and serves a claim a lien, they would no longer have their priority status over the intervening lender and would fall in line behind the mortgagee's lien. Further, if a claimant fails to file the requisite notice with the lien agent and attempts to file a claim after the property has been sold, the lien is no good—thus eliminating the hidden lien. There is a narrow exception, however, for contractors and subcontractors who are considered "last providers," such as the landscaping company. Last providers under the new law will have 15 days from first furnishing of labor or materials to file notice with the lien agent, even if the property is conveyed to an innocent purchaser.

The revised lien law substantially reduces the risk title companies now take in writing new construction coverage in North Carolina. As the changes take effect over staggered dates in 2013, the construction and real estate industry would do well to familiarize themselves with North Carolina's new lien statute. ☐

LEGAL LEAGUE 100 ~ In Pictures



(1) Shapiro & Zielke, LLP, completed its seventh annual winter fundraiser, raising a record-setting \$15,000 for 360 Communities, a local nonprofit located in Burnsville, Minnesota. Per the firm, these funds will help stock the local food shelf, provide Christmas gifts through the "armful of love" program, and further support a school program assisting disadvantaged students. **(2)** Andrew J. Lixey, operations manager, and Dawn M. Burdick, marketing manager, of Potestivo & Associates' Rochester Hills office were honored to attend the quarterly Detroit Cornerstone Schools Partner meeting. Since 2010, several of the firm's staff members have taken part in the Partner Mornings program. Each quarter, they spend two hours at



Washington-Parks Academy, where staff members are matched one-on-one with a student in grades kindergarten through eighth, using the time to listen to the child about what they are working on in school and how things are going in their life, as well as to offer mentorship. **(3)** NDeX IT Software Development team members (left to right) Raquel Schriber, Jason Buckner, Brad Wehmeyer, and Lyndsey Kelley proudly display the more than 50 gifts its team purchased for Oakland Family Services' Adopt-A-Family program as part of a yearlong corporate giving initiative at Trott & Trott, P.C., and NDeX Michigan. In total, 270 employees from both companies donated hundreds of gifts and raised \$3,300 for the cause.