

“MECHANIC’S LIEN PRIORITIES VS. OTHER ENCUMBRANCES”

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Introduction

In today’s economic environment, with financially struggling property owners and developers giving back to their lenders projects in various stages of completion, questions of priority between construction lenders and mechanics or materialmens lien claims often arise. This article analyzes the priorities between an Idaho mechanics or materialmens lien (collectively “mechanics lien”) and other encumbrances (often the trust deed or mortgage of a construction lender) against the real property involved. Generally, a mechanics lien enjoys priority only if the mechanics lien claimant began furnishing its work before the competing lien, mortgage or other encumbrance attached or was recorded.

I.C. § 45-506

Section 45-506 of the Idaho Code addresses the priority of mechanics liens compared to other liens against the real property, which are typically trust deeds or mortgages. This statute provides as follows:

45-506. LIENS PREFERRED CLAIMS. The liens provided for in this chapter shall be on equal footing with those liens within the same class of liens, without reference to the date of the filing of the lien claim or claims and are preferred to any lien, mortgage or other encumbrance, which may have attached subsequent to the time when the building, improvement or structure was commenced, work done, equipment, materials or fixtures were rented or leased, or materials or professional services were commenced to be furnished; also to any lien, mortgage, or other encumbrance of which the lienholder had no notice, and which was unrecorded at the time the building, improvement or structure was

commenced, work done, equipment, materials or fixtures were rented or leased, or materials or professional services were commenced to be furnished.

In 2001, the Idaho Supreme Court reaffirmed its 1905 decision in Pacific States Sav. & Loan & Bldg. Co. v. Deboisⁱ by holding the priority of each mechanics lien dates back to the date the lien claimant first began furnishing its labor, materials, equipment, or professional services, and if a trust deed or mortgage was recorded prior to that date, the trust deed or mortgage has priority, but if the trust deed or mortgage was recorded after the first date of furnishing work by the mechanic's lien claimant, the mechanics lien claimant has priority.ⁱⁱ Likewise, a mechanics lien claimant who begins performing its labor before a judgment creditor's attachment levy, but who does not complete its performance until after the attachment levy, has priority over the judgment creditor's attachment.ⁱⁱⁱ

The mechanics lien rights of one providing labor and material not having notice of a mortgage that was unrecorded have priority over the unrecorded mortgage.^{iv} A mortgage which has been assigned has priority over a mechanics lien attaching prior to the assignment but after the mortgage is executed.^v One who commences to provide labor and materials, equipment or professional services before a mortgage or trust deed is recorded, and then does not perfect mechanics lien rights based on representations by the lender having the trust deed or mortgage, may have claims against the lender because in reliance they did not perfect mechanics lien rights that would have had priority over the lender.^{vi}

SUBSEQUENT LOAN DISBURSEMENTS OR ADVANCES

Of course, often a mechanics lien claimant will begin work after the original loan disbursement was made (and deed or mortgage recorded). However, subsequent loan disbursements are made prior to the mechanics lien claimant completing work on the property, raising the question of the mechanics lien priority over the subsequent loan advances. The starting point is I.C. § 45-108, which provides as follows:

45-108. LIEN FOR PERFORMANCE OF FUTURE OBLIGATIONS -- VALIDITY -- PRIORITY. A lien may be created by contract, to take immediate effect, as security for the performance of obligations not then in existence, which lien, if not invalid on other grounds, shall be valid as against all persons. The validity of such contracts and liens as security for any obligation is not affected as against any person by the fact that the contract does not specify, describe or limit the obligations to be secured as to purpose, nature, time, or amount of the obligations to be secured. All such liens, if otherwise valid, are valid against and prior and superior to all rights, liens and claims acquired by other persons in the property subject thereto after the contract creating such liens was made, *except in cases where the person in whose favor the obligation secured by such lien was created, had actual notice of the existence of such subsequent right, lien or claim at the time such obligation was created*, and are prior and superior to such subsequent rights, liens or claims irrespective of such or any notice in the following cases:

1. Where the person, in whose favor the obligation secured thereby was created, was legally bound to make the advance or give the consideration resulting in such obligation.

2. Where the consideration for such obligation was necessarily and actually applied to the maintenance and/or preservation of the property subject to the lien. Making the advance or giving the consideration to result in an obligation not in existence at the time such a contract creating a lien to secure the same is made, is optional with the person making the advance or giving the consideration unless he is bound by an express contract to the contrary which shall not be implied from the fact that the contract to secure such obligation was made. Obligations otherwise within the limits and description of those specified in any contract creating a lien to secure the performance of obligations not then in existence, but created in favor of any person to whom the original party to be secured by the lien created by such contract has transferred such contract, shall also be secured thereby in like manner as similar obligations between the original parties thereto. Contracts of mortgage of real property are subject to all the provisions of this section as amended.

The key language in this statute is the exception in cases where the lender had actual knowledge of the mechanics lien claim at the time it either disbursed loan proceeds or made an advance on a credit line. However, the statute then provides that where the lender is legally obligated to make the progress payment or provide the advance, the lien for such progress payment or advance will relate back to the date the trust deed or mortgage was recorded. The Idaho Supreme Court has construed Section 45-108 to follow the general rule that if a future advance is obligatory, it takes its priority from the original date of the mortgage, and a subsequent creditor is junior to it; however, if the advance is optional, and the mortgagee has notice when the advance is made that a subsequent creditor has acquired an interest in the land, the advance loses its priority to the subsequent creditor.^{vii} Therefore, if a trust deed or mortgage requires the lender to disburse funds or make future advances, the priority for such disbursements or future advances, even if made with knowledge of a mechanics lien claim, should date back to when the mortgage or trust deed was recorded, and the mechanics lien claimant will have priority only if it began furnishing work prior to the mortgage or trust deed being recorded.

JUDGMENT LIENS

The priority between a mechanics lien claim and a judgment lien should turn on whether the judgment became a lien before or after the mechanics lien claimant began furnishing its work. A judgment becomes a lien on all real property of the judgment debtor in a county from the time a transcript or abstract of the judgment is recorded with the recorder of that county.^{viii} Therefore, a mechanics lien claimant will have priority over a judgment lien only if it began furnishing work before a transcript or abstract of the

judgment creditor's judgment was recorded in the county where the construction project is situated.

FAILURE TO DESIGNATE

The mechanics lien statute requires that the lien state the amount due. In many cases, however, the mechanics lien claimant will be performing work on several different properties, with different amounts due for each property. If the claimant fails to adequately designate the amount due on each property, could they become subordinated to the deed, mortgage or judgment lien that otherwise would be subordinate to the mechanics lien?

By statute a mechanics lien claim filed against two or more buildings or other improvements owned by the same person must designate the amount due on each building or improvement, or the lien is postponed to other liens.^{ix} Idaho courts have consistently held that a mechanics lien which fails to comply with this designation requirement is subordinate to other liens, but is not void.^x It does seem clear that a mechanics lien which fails to designate amounts due on each improvement will subordinate its lien to other mechanics lien claims that do so designate.

However, the statute is not clear as to whether this subordination extends to a trust deed, mortgage or judgment lien over which the mechanics lien claimant would otherwise have priority but for the lack of designation of amounts due on each improvement. The statute states that the mechanics lien is postponed to "other liens". It does not limit postponement to "other liens provided for in this chapter", which is how Section 45-506 begins. This lack of limitation may support an argument that subordination extends to trust deeds, mortgages and judgment liens. In contrast to the

“other liens” phrase in Section 45-508, a similar statute in Washington makes it clear that subordination is limited to other mechanics liens by use of the language “other liens that may be established under this chapter”.^{xi}

The second sentence of I.C. 45-508 limits a mechanics lien to the amount designated as against other lien creditors, which may also support an argument that a mechanics lien claim failing to designate amounts due on each improvement is subordinate to trust deeds, mortgages, or judgment liens recorded or perfected after the mechanics lien claimant began furnishing its work. The author is not aware of any cases addressing this issue.

SUMMARY

The priority of a mechanics lien dates from when that lien claimant began furnishing its labor, materials, equipment or professional services. Therefore, if the mechanics lien claimant began furnishing its work prior to the attachment of any other lien, trust deed, mortgage or other encumbrance, the mechanics lien claimant should have priority pursuant to Section 45-506 of the Idaho Code. Likewise, a mechanics lien claimant who begins furnishing its work at the time any lien, trust deed, mortgage or other encumbrance was unrecorded and for which the mechanics lien claimant had no notice should also have priority under Section 45-506. Construction lenders are sophisticated, and typically record their trust deed or mortgage prior to the commencement of any labor, materials, equipment or professional services being provided, and they obtain, as a precondition to lending, subordination agreements from anyone that has already started furnishing any labor, materials, equipment, or professional services. Therefore, in most cases a mechanics lien claim will be

subordinate to a lender's trust deed or mortgage. If the property owner does not save the project, and gives the property back to its lender, subordinate mechanics lien claims probably have little or no value.

AUTHOR BIO

Douglas R. Hookland is the managing partner in the Tigard, Oregon law firm of Scott ♦ Hookland LLP. He has been a member of the Idaho State Bar since 2003, and his practice emphasizes enforcement of creditor's rights and construction law. He received his law degree from Willamette University College of Law. He is a frequent author and presenter of written materials to attorneys and trade groups in the area of creditor's rights and construction law.



ⁱ 111 Idaho 319, 83 P.2d 513 (1905).

ⁱⁱ Ultrawall, Inc. v. Washington Mutual Bank, 135 Idaho 832, 25 P.3d 855 (2001).

ⁱⁱⁱ See White v. Constitution Min. & Milling Co., 56 Idaho 403, 55 P.2d 152 (1936).

^{iv} Poynter v. Fargo, 48 Idaho 271, 281 P.1111 (1929).

^v Finlayson v. Waller, 64 Idaho 618, 134 P.2d 1069 (1943).

^{vi} See Cooper v. Wesco Builders, Inc., 73 Idaho 383, 253 P.2d 226 (1953).

^{vii} Idaho First National Bank v. Wells, 100 Idaho 256, 596 P.2d 429 (1979).

^{viii} See I.C. 10-1110.

^{ix} See I.C. 45-508.

^x See e.g. Phillips v. Salmon River Mining & Dev. Co., 9 Idaho 149, 72 P. 886 (1903); Treasure Valley Plumbing & Heating, Inc. v. Earth Resources Co., 106 Idaho 920, 682 P.2d 322 (Ct. App. 1984).

^{xi} RCW 60.04.131 provides as follows:

In every case in which the notice of claim of lien is recorded against two or more separate pieces of property owned by the same person or owned by two or more persons jointly or otherwise, who contracted for the labor, professional services, material, or equipment for which the notice of claim of lien is recorded, the person recording the notice of claim of lien shall designate in the notice of claim of lien the amount due on each piece of property, otherwise the lien is subordinated to other liens that may be established under this chapter. The lien of such claim does not extend beyond the amount designated as against other creditors having liens upon any of such pieces of property. (Emphasis added).