

Mechanics' Liens and Title Claims

Mechanics' liens can create title claims because lenders request the removal of the mechanics' lien exception from title coverage; by removing the exception the title insurer is in effect providing coverage.

Section 1508(c) of the Mechanics' Lien Law would seem to give open-end construction mortgages priority over claims of contractors and subcontractors. But in *Kessler* (May 2012), the Pennsylvania Superior Court found that an open-end mortgage recorded AFTER commencement of construction on the mortgaged property does not have statutory priority over mechanics' liens unless ALL of the proceeds of the loan are used to pay the costs of completing erection, construction, alteration or repair of the mortgaged premises.

The Court held that if any portion of an open-end mortgage is used for purposes other than construction/repair (e.g., judgment or mortgage payoff, closing costs, transfer tax), the open-end mortgage does not enjoy priority over a mechanics' lien. In *Kessler*, work was started PRIOR to the recording of the open-end mortgage. A mechanics' lien dates back to "visible commencement" of construction. *Kessler* tells us that if construction was commenced prior to closing, and any portion of the construction loan is used for non-construction purposes, the agent should not remove the mechanics' lien exception.

One practice point is that a borrower in this scenario will need to bring money to closing on a construction loan to cover non-construction costs. I think you could successfully argue that *Kessler* is not in play if the work was commenced after the open-end mortgage was recorded; the mortgage would pre-date the visible commencement of work and would have priority. The best policy is still "no construction prior to closing."

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