

CHANGES IN PA MECHANICS' LIEN LAW PASSED

By Bradley S. Dornish, Esq.

I was about to write an article only on the changes in the Pennsylvania Mechanics' Lien Law, when it occurred to me that many real estate investors may have no idea what the law is anyway, or how it works. If you have repairs or improvements made to Pennsylvania real estate you own, you should know of this law, what it does and doesn't cover, and then I'll tell you about the changes just passed by the legislature, becoming effective January 1, 2007.

First of all, "Mechanics" doesn't refer to the guy who fixes your car. In this law, a mechanic is anyone who provides services or materials to construct, repair or improve PA real property. And a lien is exactly that, a cloud on the title of real estate if you don't pay for the materials or services put into your real estate. This is one of the things we look for in title searches, since the mechanics' lien becomes of record, and can be found in a search. The idea of contractors being able to lien the property of owners who don't pay is a good one for contractors, since they can't just go and repossess their work or materials once they go into someone else's building or grounds. However, not everyone who claims an owner hasn't paid them in full should be able to cloud the title of the owner's real estate. The law has checks and balances in it for contractors and owners, and the new changes further refine those checks and balances, as you'll see.

To have a right to lien, a contractor, subcontractor, or materialman who supplies a contractor or direct subcontractor, must have a written agreement, and must have performed under that agreement. Next, a subcontractor involved in alteration or repairs has to give written notice to an owner on or before the day they leave the job that they haven't been paid yet, and that if the contractor doesn't pay them in a timely manner, the subcontractor intends to lien the owner. This is the part of the law subcontractors don't like, because if they give the notice at that time, the contractor will get upset when the owner asks the contractor about it, and the contractor will never hire that subcontractor again. So, the subcontractors don't give the preliminary notice, and lose their right to ever file a lien.

Note that contractors don't have to give a preliminary notice, only a formal notice 30 days before they file a mechanics' lien, which lien must be filed within 4 months after the completion of the contractor's work on the job. This means the formal notice must be given within three months after the work is completed. Once the lien is filed, it creates a cloud on the title, but the owner can try to strike the lien and dispute whether he or she owes the party who filed the lien any money.

The current law allows owners to protect themselves and their property from liens by filing with the court a waiver of mechanics' liens signed by the contractor and owner before the job starts, which waiver serves as public notice not only to the contractor, but to ALL subcontractors and materialmen that they have no right to lien. Most banks require a lien waiver to be executed and filed with the court before they will advance

money on a construction loan. Because of waivers required by lenders, most contractors don't have the rights provided under the lien law most of the time.

But now we get to the changes coming January 1st, 2007. First, the new law separates residential buildings from commercial buildings. If the project is for residential, agricultural, or a planned residential development (PRD), and the total contract between the owner and contractor is for less than a million dollars, the contractor and owner will still be able to execute and file a lien waiver. Otherwise, on larger residential projects and all commercial construction, it will be against the law to waive lien rights. This will require lenders and owners to be more careful in paying contractors on all such projects where liens can't be waived. Now, the owner and bank will have to make sure that payment gets to the subcontractors and material suppliers, not just to the contractor. Otherwise, the owner could be faced with liens against the property.

The legislature did give something to the banks though, because the new law subordinates the liens of the contractors and subcontractors to purchase money and open end mortgage liens, provided the proceeds of the open end mortgage are used for the construction. I suspect some lenders will focus more on the inability to prevent liens on commercial and large residential construction mortgage loans, and will either restrict such lending in Pennsylvania, or raise their rates on such loans. On the title searching end, we are likely to see more liens being filed in and after 2007, and therefore more clouded titles on commercial real estate, and large residential construction.

Of course, use of the right entities in real estate ownership can virtually eliminate the risk of a valid lien being filed, even without a lien waiver. Using a limited partnership to hold legal title, and an LLC to manage and contract for repairs and improvements to the property can avoid many mechanics' liens, since a requirement of the current law which will remain unchanged next year, is that the contractor must have a written contract with the owner of the property. If my LLC signs a construction contract, but my L.P. owns the property, the contractor claiming a right to lien won't be able to show the written contract with the OWNER, and shouldn't be able to meet the prerequisites to lien the property. That argument has been made and won many times, and when it applies, more than justifies the cost of layering entities in the ownership of real estate.

For those who want to read the new Mechanics' Lien law, pull House Bill No. 1637 of 2005, passed by the Senate June 14, 2006, Printer's Number 4229. This is available online at www.legis.state.pa.us.