



*GHB Construction and Development Company, Inc.
v. West Alabama Bank and Trust, So What, Now
What?*

2019 Alabama Agent Seminar

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What is a Future Advance Mortgage?

“A mortgage in which part of the loan proceeds will not be paid until a future date.”

Black’s Law Dictionary 1165 (10th ed. 2014).

Future Advance Mortgage Examples

- Construction Loans
- Home Equity Loans
- Business Loans
- Commercial Loans

Overview and Risks of Construction Mortgages in Today's Economy

- Periodically disbursed after initial closing and amount of indebtedness increases with each disbursement
- Present unique circumstances requiring special considerations
- Pose significant risks for title insurers
- Highly scrutinized and require specific title underwriting analysis
- Mechanics' liens can present significant claims for title insurers
- Always consult with underwriting counsel about transaction specific matters

Mechanics' Liens, so what are the risks?

- In Alabama mechanics' liens are purely statutory and codified at Ala. Code §§ 35-11-210 to 35-11-234 (1975)
- The lien arises when the claimant makes the contribution, but remains inchoate until action is taken to enforce the lien
- Relates back to the date of the initial contribution of labor or materials and could jeopardize priority of construction mortgage
- Two types of liens
 - “Full price” lien - contract between lien claimant and owner
 - “Unpaid balance” lien - no express contract between lien claimant contributing materials and the owner.
- Lien claimant must strictly comply with statutory mandates for the perfection of any claimed lien, and if there is a failure, he becomes merely a general creditor and loses status as a lien claimant

Mechanics' Liens-Verified Statement

- Time for Filing: Ala. Code § 35-11-215 (1975)
 - Original Contractor 6 months
 - Day Laborers and Journeymen 30 days
 - Other Claimants 4 months
- Every person entitled to a lien must file a verified statement, substantially in form as required by § 35-11-213, in the office of the judge of probate of the county in which the property is situated. Generally speaking “original contractors” must record a verified statement within six months, day laborers and journeymen within thirty days and all other claimants within four months of the date of their last contribution of labor or materials

Mechanic's Liens-Enforcement by Civil Action

- Commencement of Civil Action: Ala. Code § 35-11-221 (1975)
- Civil Action 6 months
- In order to enforce and perfect a lien, a civil action must be brought within six months of the maturity of the indebtedness. Absent an agreement between the parties, a debt generally matures and becomes due and payable on the day the last work is performed or materials supplied.

Lienable Contributions-Labor

- Depends on the nature of the labor contributed (ex. original contractor or day laborer)
- Must be established that the labor was performed upon or contributed to something that has attached to and become part of the realty upon which the lien is claimed
- Determined to be contribution of labor for improvement on land:
 - Clearing, grading, and site preparation of raw land
 - Demolition of existing structures
 - Site inspection by architect for progress of work
- Determined not to be contribution of labor for improvement on land:
 - Mere preparation of building plans by architect
 - Surveying, lot staking and map or plat preparation by a surveyor

Lienable Contributions-Materials

- Materials must actually be contributed to and incorporated into improvements
- Contract modifications or change orders can result in extensions of the date of maturity of the indebtedness, therefore creating a different time within which to bring the civil action to perfect and enforce a lien

Lienable Contributions-Other

- Waste disposal services
- Equipment or Machinery Rental

ALTA 2006 Loan Policy of Title Insurance

COVERED RISKS

SUBJECT TO THE EXCLUSIONS FROM COVERAGE, THE EXCEPTIONS FROM COVERAGE CONTAINED IN SCHEDULE B, AND THE CONDITIONS, The Company, insures as of Date of Policy and, to the extent stated in Covered Risks 11, 13, and 14, after Date of Policy against loss or damage, not exceeding the Amount of Insurance, sustained or incurred by the Insured by reason of:

11. The lack of priority of the lien of the Insured Mortgage upon the Title
 - (a) as security for each and every advance of proceeds of the loan secured by the Insured Mortgage over any statutory lien for services, labor or material arising from construction of an improvement or work related to the Land when the improvement or work is either
 - (i) contracted for or commenced on or before Date of Policy; or
 - (ii) contracted for, commenced, or continued after Date of Policy if the construction is financed, in whole or in part, by proceeds of the loan secured by the Insured Mortgage that the Insured has advanced or is obligated on Date of Policy to advance

ALTA 2006 Loan Policy of Title Insurance

THE EXCEPTIONS FROM COVERAGE CONTAINED IN SCHEDULE B

- Standard Mechanic's Lien Exception:

Item _____. Any lien or right to a lien for service, labor or materials heretofore or hereafter furnished, imposed by law and not shown by the public record

- By virtue of deleting the above exception, mechanic's lien coverage is afforded to the insured lender

GHB Construction and Development Co., Inc.

v.

West Alabama Bank and Trust,

___ So. 3d ___ (September 21, 2018)

WL4871133

Appeal from Walker Circuit Court
(CV-17-900006)

Timeline of Events

- April 8, 2015 – Penny Guin executed promissory note and optional future-advance mortgage in favor of WABT.
- April 9, 2015 – Guin entered into contract with GHB to construct house on property.
- April 10, 2015 – WABT recorded mortgage in the Office of the Judge of Probate, Walker County, Alabama.
- October 16, 2015 – WABT issued first advance in the amount of \$105,000.00

Timeline of Events

- July 25, 2016 – GHB having completed construction, submits to Guin the final bill for work.
- December 20, 2016 – GHB alleges Guin has not paid final bill and files verified statement of lien in the amount of \$106,556.16.
- January 6, 2017 – GHB sues WABT, Guin and several fictitiously named parties, in order to perfect its lien.

Facts and Procedural History

- Optional future-advance mortgage securing a promissory note stating “the *conditions for future advances* are at the request of Guin *and the approval of the loan officer.*”
- At closing, WABT did not advance any funds to Guin.
- After execution of construction contract, GHB commences construction of Guin’s home and contributed labor and supplied various materials.

Facts and Procedural History

- Nothing in the trial record indicated the specific date on which GHB delivered materials to Guin's property or when construction commenced.
- WABT filed motion to dismiss GHB claims arguing that its mortgage was recorded before GHB delivered materials or contributed labor, and therefore had priority over GHB's materialman's lien.

Facts and Procedural History

- GHB files response to WABT's motion to dismiss, arguing that WABT's mortgage did not "secure" any indebtedness until funds were advanced to Guin, which did not occur until after GHB commenced work or delivered materials.
- Circuit Court granted WABT's motion and dismissed GHB's claims against WABT.
- Ultimately GHB appeals trial court's final order.

Issue

Whether it is possible for GHB to demonstrate that its materialman's lien is superior to WABT's mortgage?

Analysis

- The priority of mechanic's liens is governed by Ala. Code § 35-11-211 (1975), which states in pertinent part"
 - (a) [A mechanic's or materialman's] lien as to the land and buildings or improvements thereon, shall have priority over all other liens, mortgages, or incumbrances created subsequent to the commencement of work on the building or improvement. Except to the extent provided in subsection (b) below, all liens, mortgages, and incumbrances (in this section, "mortgages and other liens") created prior to the commencement of such work shall have priority over all liens for such work.

Analysis

- Under Morvay v. Drake, 325 So. 2d 165 (Ala. 1976), though the mortgage at issue was not a future-advance mortgage, the Alabama Supreme Court held that a mortgage which does not secure an actual debt, may be declared void for failure of consideration.
- Both at common law and under Alabama case law, future-advance mortgages are valid. However, no state case found where such a mortgage did not initially secure some debt.

Analysis

- Court looked at treatises and authority from other jurisdictions that address the issue, which indicate that a future-advance mortgage does not create a mortgage lien until some indebtedness is incurred by the mortgagor.
- Further, the Court cited that “a mortgage to secure future advances, which are optional, does not take effect between the parties as a mortgage until some advance has been made...”

Conclusion

- Based on the rule in Morvay, the Court held that a future-advance mortgage does not create a mortgage lien until some indebtedness is incurred by the mortgagor under the future advance mortgage.
- Applying this rule, WABT's mortgage was not created when Guin executed the note and mortgage or at the time of recording, but rather on October 16, 2015 when initial funds were advanced to Guin.
- Therefore it's possible that GHB's lien was created before WABT mortgage, and trial court erred in granting WABT's motion to dismiss.

Now What?

- September 21, 2018 – Decision Released
- October 19, 2018 – Application for Rehearing Filed
- October 19, 2018 – Amici Curiae Brief Filed
- 2019 Alabama Regular Legislative Session?

Underwriting Considerations

- Type of mortgage? (construction loan, future advance, HELOC, etc.)
- Will any portion of the loan be funded at closing?
- Are the advances obligatory or optional?
- If construction, require subordination and lien waiver from general contractor/builder.

Underwriting Considerations

Example of obligatory language:

REVOLVING LINE OF CREDIT. This Mortgage secures the indebtedness including, without limitation, a revolving line of credit, which obligates Lender to make advances to Grantor so long as Grantor complies with all the terms of the Credit Agreement. Such advances may be made, repaid, and remade from time to time, subject to the limitation that the total outstanding balance owing at any one time, not including finance charges on such balance at a fixed or variable rate or sum as provided in the Credit Agreement, any temporary overages, other charges, and any amounts expended or advanced as provided in either the Indebtedness paragraph or this paragraph, shall not exceed the Credit Limit as provided in the Credit Agreement. It is the intention of Grantor and Lender that this Mortgage secures the balance outstanding under the Credit Agreement from time to time from zero up to the Credit Limit as provided in the Credit Agreement and any intermediate balance.

Example of optional language:

Future advances of proceeds of the Loan will be made in Lender's sole and complete discretion generally based on the advance procedures set forth in the Loan Agreement, including, without limitation, the provisions of Section ___ of the Loan Agreement dealing with Advances of Loan Proceeds. Additionally, in connection with any request for any future advance of proceeds of the Loan, Borrower shall provide, or cause Guarantor or any other applicable party to provide, such documentation and information requested or required by Lender in its complete and sole discretion. Borrower covenants and agrees that it will not request, and Lender shall have no obligation to make, an advance of proceeds of the Loan (i) after the occurrence of an Event of Default (as defined below) or any event which with notice, lapse of time or both would constitute an Event of Default or (ii) after the Conversion Date. Borrower understands and agrees that the maximum advances of the Loan, including that certain advance made on the date hereof, will be Seven Hundred Thousand and No/100 Dollars (\$700,000.00).

Considerations for Residential Construction

- Generally mechanic's lien coverage is not given during the period of construction
- Therefore, the mechanic's lien exception should be included in construction loan policy insuring residential construction, as shown below

Item _____. Any lien or right to a lien for service, labor or materials heretofore or hereafter furnished, imposed by law and not shown by the public record

Considerations for Commercial Construction Projects

- Availability of mechanic's lien coverage is generally determined on a transaction specific basis with guidance and approval from underwriting counsel
- One should be prepared to request and obtain additional information from the borrower in order to evaluate the availability of such coverage
- Additional time should be expected when mechanic's lien coverage is requested to properly underwrite the transaction
- Communicate as soon as possible that the transaction involves construction and the lender is requesting mechanic's lien coverage

Considerations for Commercial Construction Projects

- Appraised amount of the project
- Reputation and experience of general contractor
- Who will be collecting lien waivers as construction progresses
- Recent financial statements of the borrower and any other indemnitors (if priority has been jeopardized)
- Payment and Performance Bond
- Will lender require issuance of date down endorsement prior to each funding of construction draw

Considerations for Commercial Construction Projects

- Require a draft copy of the note and mortgage, along with any credit or funding agreements, to determine nature of advances.
- Must include pending disbursement clause in loan policy.
- If construction, has work commenced?
- Require subordination and lien waiver from general contractor/builder, suppliers, etc.

Establishing Priority of the Construction Mortgage

- It is CRITICAL to establish priority so there is no impairment or loss of the security of the insured mortgage
- Obtain properly executed Non-Start Affidavits from the owner and contractor stating that no work has been performed and no labor or materials have been supplied to the land to be insured
- In some cases it may be necessary to visually inspect and photograph the site to verify work has not commenced
- Prompt recordation is essential in protecting the interests of the insured

Lost Priority of the Construction Mortgage

- Contact underwriting counsel immediately!
- Be prepared to satisfy additional underwriting requirements and possibly a delayed closing
- In some cases mechanic's lien coverage may not be available, or
- Exception to certain previously commenced work or supplied materials may be required
- Bond requirement

Lost Priority of the Construction Mortgage

- General requirements include:
 - Mechanic's and Materialmen's Lien Indemnity Agreement
 - Individual
 - Business Entity with Guarantors
 - Business Entity without Guarantors
 - Sworn Construction Statement as to payment of work
 - Owners and Contractors Affidavit and Agreement
 - Full or Partial Lien Waiver from General Contractor or Subcontractors
 - Subordination Agreement
 - Contractor's Affidavit and Release
- In some instances an Escrow and Indemnity Agreement may be necessary
- Bond naming title insurer as obligee
- Financial Statements of Owner, Principal or General Contractor

Lost Priority of the Construction Mortgage

- ALTA 32 Series Construction Loan Endorsements
 - Used in situations when there is limited or no priority for the lien of the Insured Mortgage over later filed mechanics' liens and where the agent will be reviewing draw request and disbursement records whether or not the title agent is acting as the disbursement agent
- ALTA 33-06 Disbursement Endorsement
 - Used solely in connection with the ALTA 33 Series Endorsements and acts as a date down endorsement for construction disbursements
 - 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
 - Requires the insertion of any additional exceptions resulting from the title search performed in connection with the issuance of the endorsement

Thank You!

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