

2025 Title Tenets Webinar Series

# Underwriting Mechanic's Liens & Overcoming Broken Priority

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# Scenario 1 - Broken Priority

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ChatGPT became conscious and decided to build a large data center to house itself. It partnered with Meta and they created MetaMind Industries LLC (“MetaMind”).

MetaMind purchased some land and began constructing a revolutionary data center with its own funds. However, constructing this massive data center required substantial capital. While MetaMind was probably capable of funding the project itself, it wanted to spread the risk and obtain a construction loan.

The Construction Lender will not accept any exceptions for mechanic’s liens and wants affirmative coverage over any existing mechanic liens.



# Mechanic's Lien Laws

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- “First Spade”
- Notice of Commencement/Contract
- No Priority
- Priority Based on Recording
- Mechanic's Lien Registry
- First Tier vs 2<sup>nd</sup> tier
- Time frames
- On-site vs off-site



# Resolution: Quantify the Risk

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- Copy of the Construction contract
  - What is the project? Ground up construction? Interior Renovations? Something else?
  - Fixed or cost plus?
  - Guaranteed maximum price
- Construction Budget – think about current supply chain issues and/or increased material costs
  - Contingency
- Sources and Uses of Funds
- Disbursement/Draw Schedule
- Statement of amount disbursed to date
- Lien Waiver Audit
- Who is or will be making disbursements? And to who?

# Resolution: Indemnity?

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Who will provide an Indemnity?

Does Indemnitor have the financial strength to support the mechanic lien risk?

- Obtain current, audited financial statements for the proposed indemnitor
- Does indemnitor have enough cash/liquid assets to support the mechanic lien risk?
- Best practice = obtain indemnities from both developer/indemnitor and the General Contractor.

# Indemnitor Falls Short

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- Secured indemnity
  - Cash escrow
- Construction loan funds sufficient to complete project?
- Equity in project
- Can the risk be bonded?
- Subordination?
  - Is a subordination even enforceable in the state?



# Title Insurance Coverage

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Pending disbursement clause = insures the amount actually disbursed and increases as disbursements are made up to the face amount of the policy.

The Alta 32 provides coverage to an insured lender and insures:

1. Validity and enforceability of the insured instrument as to each construction loan advance
2. Priority of each construction loan advance over mechanic's liens existing on or before the Date of Coverage



# Alta 32 Series and Alta 33

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Alta 32 = provides coverage for amounts shown as due and owing in the documents supporting the loan advancement and amounts which are distributed by the insured lender or on the insured lender's behalf

Alta 32.1 = provides coverage only for direct payments made or approved by the Title Insurer

Alta 32.2 = provides coverage only for direct payments made by the insured lender or on behalf of the insured lender

Alta 33 = gets issued with each construction loan disbursement insures the aggregate amount disbursed as of the Date of Coverage

- ▶ Date of Coverage = date inserted into endorsement which is updated each time it is issued to a later date.
- ▶ Aggregate amount of insurance updated with each issuance

# Scenario 2 - Construction Complete

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MetaMind constructed such an enormous data center that there is no way it could possibly use all the space on its own. MetaMind wants to sell portions of the data center to buyers who will finance their acquisitions. The lenders will of course require mechanic's lien coverage.





# Steps to Resolution

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- Establish the time of completion – has statutory lien period passed?
- If unable to determine with certainty that the time for filing liens has expired, the transaction should be treated as having broken priority
  - Establish type of lien law state
  - Quantify risk
  - Obtain indemnities from a financially strong indemnitor

# Scenario 3 - Lien

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MetaMind is in a dispute with the General Contractor because the GC did not make enough room for cooling systems. MetaMind refuses to pay the GC until they correct this issue. The GC filed a lien for its unpaid invoices. MetaMind is in the process of selling off a large portion of this enormous data center to Amazon. Amazon refuses to accept a title policy with an exception for the mechanic's lien. MetaMind doesn't want to pay the GC until the cooling system area is corrected. And the GC will not release its lien until they get paid.



# Lien on record – how do we close?

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- Upfront unconditional bond
  - Payment bond
  - Performance bond
  - Time frames
- Transfer lien to security
- Escrow
- Indemnity
  - Should it be secured?

# Scenario 4 - Tenant work

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# Scenario 4 -Tenant work

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MetaMind completed construction and entered into a ground lease with a trampoline park so that employees working at this enormous data center can blow off some steam and jump around on their lunch break. The tenant will need to do some interior construction work to build out their space. MetaMind needs to refinance its construction loan to permanent financing. MetaMind's new lender wants mechanic's lien coverage. We are assuming for this scenario that the time period for filing liens for construction of the Data Center has passed.



# Tenant Work

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- Are liens for work performed by tenants allowed to attach to the fee in this jurisdiction?
  - “Pith of the lease”
  - Does the law allow the owner to limit the extent of the lens for tenant work?
- If the lien attaches to the fee then treat as if it is a construction loan
  - Quantify the risk
  - Indemnity
  - Bond
  - Subordination



# Thank you. Questions?

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