



# ALTA

# inSIGHTS

REAL TIME | ON-DEMAND



## Navigating Mechanic's Liens in Commercial Transactions

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Today's  
ALTA Insights  
Featured  
Sponsor

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# Speakers

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National Commercial Underwriting Counsel | First American Title Insurance Co.



# What Is a Mechanic's Lien?

- **Definition**

- Lien created by statute to secure payment for work performed and materials furnished to construct (or repair) improvements to land



# Basics for Mechanic's Liens



- Equity and avoidance of unjust enrichment



# Different Types of Liens

## Inchoate Interest or Lien

An interest which is **not** a present, **perfected** interest but which may ripen into a perfected interest

## Choate Interest or Lien

An interest for which all conditions precedent have been satisfied, and which is **perfected**



# Who Can File a Mechanic's Lien?

Professional Services

Contractors/Subcontractors

Materialman and Suppliers

Laborers



# Lienable Work



Hard vs. Soft  
Costs



Demo and  
Repair



Excluded  
Matters



Improvements



# What Property Is Lienable?

Fee Simple

Leaseholds

Homeowners' Association Property

Condominiums and Cooperatives

Easements



# What Property Is Lienable?

Tenant Improvements

New Development – individual lot or whole development?

Government-owned property, used for governmental purposes, is not subject to mechanics' liens



# Reasons to File a Mechanic's Lien

Construction Contract Change Orders or Upgrades

Scheduling Difficulties and Delays

Failure of the Lender to Fund a Draw Request

Failure of the Owner/Borrower to Make the Scheduled Payments

A Dispute Between the Contractor and the Subcontractor or Supplier

Other Dispute Between the Contractor and the Owner

Running of Statute regarding time to file a lien



# Poll Question

- **What type of properties are not subject to mechanic's liens?**
  - Shopping centers
  - Government-owned
  - Office buildings
  - Industrial



# Priority and Mechanic's Liens



# Priority in Mechanic's Liens Setting

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Mortgage/DOT vs Lien Claimant

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Priority between Lien Claimants

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Order of Payment

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New mortgage during lien filing period





# State Law Differences

## Absolute priority for Mortgage States

- Mechanics' liens are not an issue

## "Safe Harbor" States

- Good priority if under a statutorily provided priority status

## Factual Priority States

- ML claims relate back to first physical improvement on the property

## Absolute priority for lien claimant states

- No guaranty of priority for Mortgage/DOT until after disbursed and payment made

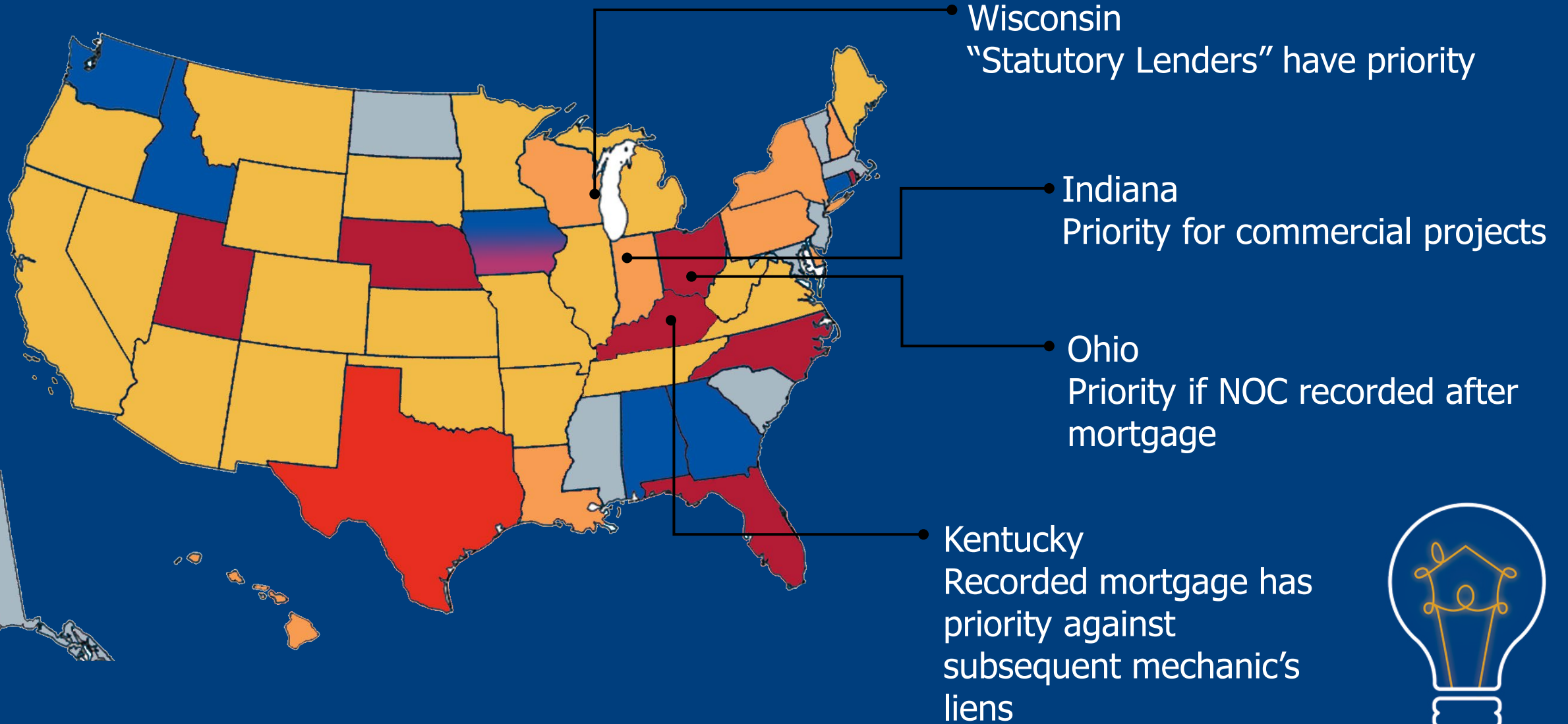


# Safe Harbors

- ◆ Race-to-the-Courthouse States – “First in Time, First in Right”
- ◆ Safe Harbors for Mortgages and Deeds of Trust
- ◆ Loan or Lien Doesn’t Necessarily Always Have Priority Over the Other
- ◆ Some States are in a “World of their Own.”

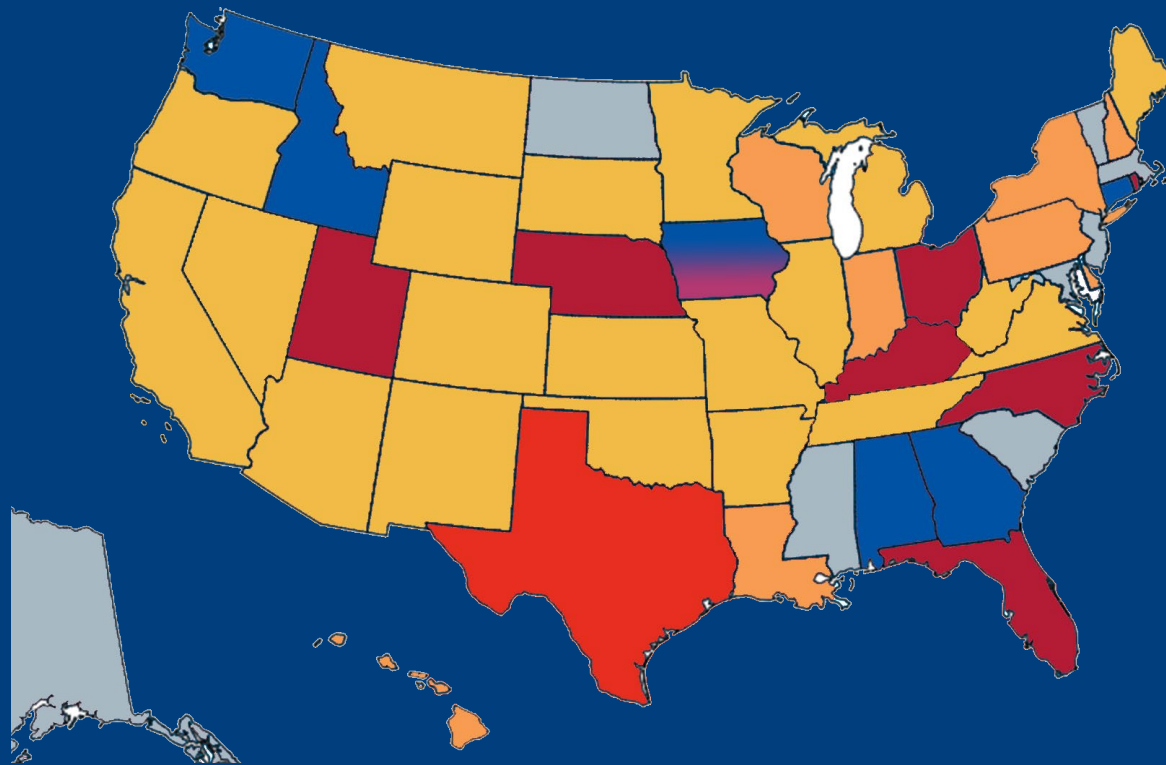


# Mechanic's Liens Laws



# Losing and Regaining Priority

- Whether priority is maintained as to future payments depends on the answer to this question:
  - What is the mechanic's lien law in the respective state?



# Recording Requirements and the Gap

Effective Date of Commitment

GAP

Recording of instruments

Lien Waivers through date

GAP

Payment/Endorsement Effective Date

Draw search-through date

GAP

Payment/Endorsement Effective Date

↓  
RISKS



# How Is Mechanic's Liens Coverage Provided?



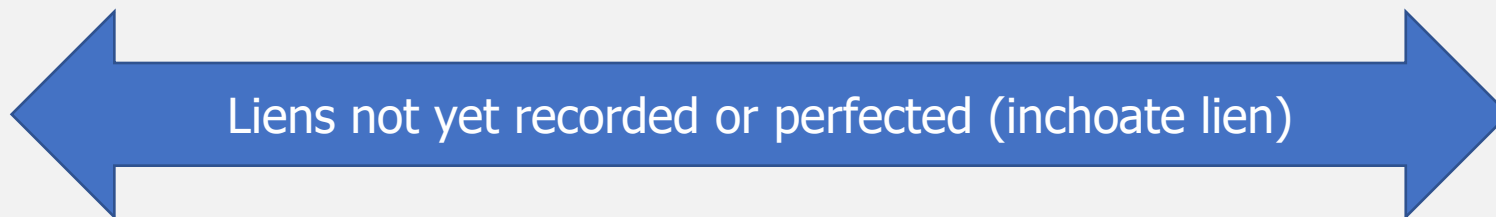
# General Title Insurance Considerations

## Most Title Insurance Coverage



Easements, mortgages, deeds of trust, covenants, agreements, etc.

## Mechanics' Liens



Consideration of risks

Priority issues  
Enforcement issues  
Related policy coverage issues

# Why Should You Care About Priority?

Owner's Policy	Loan Policy
<p><b>Covered Risk 2</b> against defects, liens and encumbrances</p>	<p><b>Covered Risk 2</b> against defects, liens and encumbrances</p> <p><b>Covered Risk 10</b> lack of priority over other liens or encumbrances</p> <p><b>Covered Risk 11</b> the lack of priority over certain mechanic's liens</p>



# ALTA 2021 Owner's Policy

Covered Risk 2

Defects, Liens and  
Encumbrances

Any defect in or lien or encumbrance on the Title. Covered Risk 2 includes, but is not limited to, insurance against loss from...



# ALTA 2021 Loan Policy

## Covered Risk 2

Defects, Liens and  
Encumbrances

Any defect in or lien or  
encumbrance on the Title.  
Covered Risk 2 includes, but  
is not limited to, insurance  
against loss from ...



# ALTA 2021 Loan Policy

Covered Risk 10

Lack of priority of the lien  
of the Insured Mortgage

The lack of priority of the lien  
of the Insured Mortgage  
upon the Title over any other  
lien or encumbrance on the  
Title as security for the  
following components of the  
Indebtedness:



# ALTA 2021 Loan Policy

## Covered Risk 11(a)

Lack of priority as security for each advance of the Mortgage over mechanic's liens

The lack of priority of the lien of the Insured Mortgage upon the Title:

- a. as security for each advance of proceeds of the loan secured by the Insured Mortgage over any statutory lien for service, labor, material, or equipment arising from construction of an improvement or work related to the Land when the improvement or work is:
  - i. contracted for or commenced on or before the Date of Policy; or
  - ii. contracted for, commenced, or continued after the 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 the Date of Policy to advance;



# Mechanic's Lien Exception

## "Standard Exception"

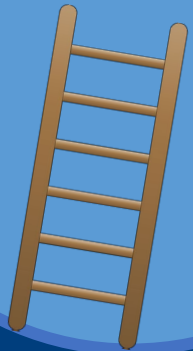
Any lien or right to a lien for services, labor, material or equipment unless such lien is shown by the Public Records at Date of Policy.



# Mechanic's Lien Coverage Options

How do we provide insurance to lenders?

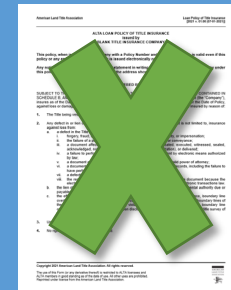
Incremental  
coverage



Pending  
disbursement



Standard  
exception



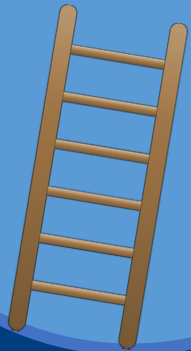
# What Is Incremental Coverage?



# Mechanic's Lien Coverage Options

How do we give incremental coverage?

Incremental  
coverage



# ALTA 32 Series Incremental Coverage

## ALTA 32 Incremental Coverage

Deletes Covered Risk 11(a)

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Creates “Date of Coverage” as a defined term

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Insures against

Invalidity or unenforceability of the mortgage lien

Lack of priority for mortgage lien as security for each advance prior to DOC over any Mechanics’ Lien if notice of the ML is not filed or recorded in the Public Records



# ALTA 32 Series Incremental Coverage

Lack of priority for mortgage lien as security for each advance prior to DOC over any Mechanics' Lien if notice of the ML is not filed or recorded in the Public Records

## ALTA 32

Only to extent the charges for which the ML is claimed were designated for payment in the documents supporting the advance disbursed by or on behalf of the Insured on or before DOC

## ALTA 32.1

Only to extent direct payment to the ML claimant for the charges for which the ML is claimed has been made by the company or by the insured with the company's written approval

## ALTA 32.2

Only to extent direct payment to the ML claimant for the charges for which the ML is claimed has been made by the insured or on the insured's behalf on or before DOC



# ALTA 33 Disbursement Endorsement

Moves Date of Coverage forward

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ALTA 33  
Disbursement  
Endorsement

May designate the current disbursement and aggregate amount Company recognized as disbursed

Allows for Amendment of Schedules A and B  
(Should only be used with extreme caution)

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Does NOT move Date of Policy



# Exception to Use With Incremental Coverage

## ALTA 32 series or Endorsement Schedule B

Any statutory lien or claim of lien, not shown by the Public Records at Date of Policy, that arises from services provided, labor performed, or materials or equipment furnished, except as insured by the ALTA 32 Endorsement as it may be revised by any ALTA 33-06 Endorsement.



# Pending Disbursement Provisions

- Coverage limited to amount disbursed at closing until
  - Additional funds advanced OR
  - Additional funds advanced AND recognized by endorsement



# Be Careful With Endorsements



- **Some Endorsements Might Restore Priority Coverage**
  - ALTA 14 Series
  - Other Types of Revolving Credit Endorsements
  - Modification Endorsements
    - Watch out for anything which might move the Date of Policy



# Mechanic's Lien Underwriting

- What is the last way to provide ML coverage?



# Poll Question

- **Which state gives priority to the recorded mortgage against subsequent mechanic's liens?**
  - Kentucky
  - Ohio
  - Indiana
  - Wisconsin



# How to Tell the Story and What Documents are Needed?



# The “Old Way”

Before the Great Recession



Relied on evidence of priority

Lessons learned

- ✓ We get mechanic's lien claims
- ✓ Litigating priority is expensive
- ✓ Litigating priority is rarely successful
- ✓ Inspections are often insufficient and/or MIA
- ✓ Indemnities from failed developers are worthless
- ✓ Many times, just opportunity for another round of litigation



# The New Way of Doing Things

Before the Great Recession

After the Great Recession



- ✓ Do we know the builder, the GC, and the lender?
- ✓ Does the project make sense?
- ✓ Are there sufficient funds?
- ✓ Is there equity (good LTV)?
- ✓ Will the lender have provable priority?
- ✓ Creditworthy indemnitors?

Focus on project viability and management of lien risk

Focus on project viability



# The New Way of Doing Things

After the Great Recession



- ✓ Documenting good priority
- ✓ Appropriate indemnity support
- ✓ Borrower, Guarantors, GC
- ✓ Use of incremental coverage

Focus on project viability and  
management of lien risk

Focus on management  
of lien risk



# Telling the Story

- **Who is involved?**
  - Owner
  - Contractor
- **What is being built? What will it cost?**
- **When will construction begin and end?**
- **Where will construction take place (state)?**
- **How will draws be handled and/or reviewed?**



# Documents Needed for Review

- Underlying Construction Contract
- Appraisal
- Loan Agreement and Mortgage/Deed of Trust
- Budget with Sources and Uses; Draw Schedule
- Mechanics' Lien Indemnity
- Financials for proposed Indemnitor



# Fact Patterns and Scenarios



# New Construction – Scenario 1

- Construction of new market-rate apartment complex in major metro area
- Total Project Cost: \$125,844,000.00
- Construction Contract: GMP \$94,044,000.00
- Soft Costs: \$31,800,000.00
- Developer with track record
- National Contractor
- Construction to take 23 months – draws expected to range from 1,250,000 to \$7,900,000, with an average draw of \$4,613,800
- Indemnitor financials show cash of \$10 million + stocks/bonds of \$25 million



# Adaptive Reuse – Scenario 2

- Historic post office being converted to a mixed-use project – apartments, hotel and retail
- Total Project Cost: \$185,213,000.00
- Construction Contract: GMP \$104,000,000.00
- Soft Costs: \$81,213,000.00
- Developer with track record
- Regional Contractor
- Construction to take 27 months –with an average draw of \$5,341,222
- Indemnitor financials show cash of \$5 million + stocks/bonds of \$25 million



# Q&A



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