



## COUNSELOR'S CORNER

# Reviving Construction Projects — How to Avoid Creating a Frankenstein Monster

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**R**eviving dead or moth-balled projects presents risks and rewards. The rewards include a shorter ramp-up period. The risks include the revival of claims akin to the unintended creation of a Frankenstein monster. But those risks may be eliminated, reduced or monetized early in the process. Below are some tips for avoiding traps that jeopardize the recorded priority of construction loans.


- 1. The Relation Back of Priority for Professional Service Liens.** Beware that actual notice of professional services may cause the professional services' lien to relate back for the purpose of priority over a recorded mortgage — at least, that is what the Washington Court of Appeals has recently ruled. Normally, a recorded mortgage takes priority over unrecorded interests. Washington's construction lien statute creates some exceptions. A design professional must normally record a Notice of Professional Services to create priority for work being performed prior to construction. But a lender's recorded mortgage may still lose priority even when a design professional fails to record the Notice of Professional Services. This occurs if the lender had actual notice of the design professional's services. Lenders can avoid this kind of priority dispute through due diligence and by having all design professionals for the project sign a subordination agreement.
- 2. The Revival of Expired Construction Liens.** Beware that amendments to an earlier contract could cause work to relate back to the original work performed and therefore cause an expired construction lien to leapfrog ahead of a recorded mortgage. A construction

lien will expire when it is not recorded within 90 days after completion of the work. A recorded lien will expire if a foreclosure suit is not brought within eight months after recording. Restarting work under the same contract or an amended contract may revive the priority of an expired lien. A lender should address the risk proactively through informed decisions and appropriate documentation.

- 3. Possible Liability From Using Stale Design Drawings.** Beware that using prior drawings and plans when restarting a project may trigger licensing and copyright claims. The use of stale drawings also raises possible issues about code compliance and incomplete designs. During the economic downturn, a number of projects were put on hold. As the economy begins heating up and these projects are revisited, sometimes new design professionals are brought on board to pick up where the prior team left off. Depending on the contracts, the owner may not have the right to use the prior design and plans. The legal authority to use the drawings and works should be dealt with upfront by requiring all design professional contracts to include an irrevocable license for copyrightable works. Also, the revived project should be evaluated for possible code compliance and incomplete design issues.
- 4. Possible Unjust Enrichment Liability to Contractors.** Beware that unjust enrichment liability of construction lenders to contractors may be triggered by actual knowledge of a contractor's ongoing work and statements to the contractor (or possibly from inaction) plus inequitable circumstances. After the borrower

defaults, a lender could be liable for a contractor's construction costs if the lender encourages or leads the contractor to believe that if the contractor continues working on the project it will be paid. Reduce this risk by including contact provisions that authorize lender communications with contractors and utilizing those authorized communications under the watchful eyes of your legal counsel.

- 5. The Forfeiture of Priority From the Failure to Act: Stop Notices and Lien Foreclosure Suits.** Beware that failing to honor a stop notice leads to subordination of your secured loan. Notify the borrower immediately upon receipt of a stop notice and put controls in place to stop future payments on the project. Also, beware that failing to defend or intervene in a construction lien foreclosure suit brought by a substantially junior construction lienholder may lead to the lien leapfrogging ahead of your secured loan. Finally, beware of construction lien foreclosure suits that merely join the originating lender of a MERS ("Mortgage Electronic Registration Systems, Inc.") deed of trust — ones that fail to join MERS or lenders that have been assigned the loan.

As evidenced by the number of cranes in the air, the economy is heating up. With due diligence and foresight, you can reduce the risk of creating another Frankenstein. 



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