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10 Good Reasons Lenders Should Say No to Priority Losses

1. Goodwill

If you permit the borrower to start construction before your deed of trust is recorded you are relying on the borrower's ability to get the title company to accept an indemnity to issue its policy without exception to possible mechanics' liens. The title company may not accept the indemnity. If the indemnity is refused you cannot fund the loan and that will create a loss of goodwill with the borrower.

2. Added Costs

Even if the title company issues its policy the lender may face added costs when mechanic' liens are recorded. Your staff, particularly the senior management and legal department, will spend additional hours on settlement negotiations and legal actions.

3. Closing Delays

The inspection for priority of a deed of trust is not made until the recording is anticipated. When the title company inspection reveals construction has started, closing is delayed while the title company gathers the facts if needs to evaluate the acceptability of the risk created by the start of construction prior to recordation of the deed of trust.

4. Litigation Delays

In the event mechanics' liens are recorded, a sale of your loan or its payoff may be delayed. The title company may decide to challenge the validity of the liens. While the needed litigation proceeds you may incur months or years of delay in selling your loan or having it paid off. You do not have the control you would have when prior recordation is achieved.

5. Loss of Take-out Lender

A take-out lender may not purchase your loan or make a new loan in the face of recorded liens even if the title company insures against loss or damage because of enforcement of the liens. By law, many lenders must have a first lien position, and special insurance by the title insurer does not meet those legal requirements.

6. Marketability of Title

A buyer may decline to buy the completed work of improvement of any mechanics' liens are recorded. This could result in your funds being tied up longer than expected resulting in a loss of earnings.

7. Adverse Publicity

In the event of legal action the lender's name is used in the suit, not the title company's. Such adverse publicity is not needed.

8. Bankruptcy Delays

To forestall foreclosure of a mechanics' lien the borrower may file bankruptcy. In that event your funds are tied up for periods of time far in excess of those contemplated when the loan fees were charged.

9. Foreclosure Problems

The foreclosure of a deed of trust recorded prior to the start of construction generally extinguishes mechanics' liens. Such is not the case if construction starts before recordation of your deed of trust. If the deed of trust is recorded after the construction commences all lien claimants' interests may be superior to the deed of trust. This is true even if the lien claimant started work after the deed of trust has been recorded. All lien claimants' rights begin at the same time, that is, at the time the first work is started on the project.

10. You do NOT have the control you would have when prior recordation is achieved.

Prevent Problems. While no one makes a construction loan expecting problems, we must recognize that problem projects do arise. The best way to avoid problems is to anticipate them. Insist on prior recordation of the construction loan. Remember, a deed of trust recorded before the start of construction and before materials are furnished is prior to the claims of any mechanics' liens.

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