

Pennsylvania Mechanic Liens Made Stronger By Recent Lien Priority Case



A recently published Pennsylvania Superior Court case significantly changed how mechanics lien priority is determined between lien claimants and banks with an open-ended mortgage. The decision - Commerce Bank Harrisburg NA v. Kessler - is decidedly pro-contractor or pro-supplier, and has already made an impact in determining lien priority on other cases throughout the state.

Defining Open-Ended Mortgages in Pennsylvania Mechanics Lien Law

The Kessler decision affects what is called "open-end mortgages." A general definition of this type of investment instrument is as follows (courtesy Investopedia):

A type of mortgage that allows the borrower to increase the amount of the mortgage at a later time. Open-end mortgages permit the borrower to go back to the lender and borrow more money if certain conditions have been met. There is usually a set dollar limit on the additional amount that can be borrowed.

Pennsylvania's Mechanics Lien Law gets more specific about what constitutes an "open-end mortgage" in the mechanics lien context, providing in 49 P.S. 1508(c) that a mechanics lien is subordinate to:

Pa.C.S. § 8143(f)...the proceeds of which are used to pay all or part of the cost of completing erection, construction, alteration or repair of the mortgaged premises secured by the open-end mortgage.

Mechanics Lien In Kessler Pitted Against Open-End Mortgage Lending Money For More Than Just Improvements

The Kessler case presented a situation that is common in the open-end mortgage world, and exposed a long-running ambiguity in Pennsylvania's Mechanics Lien Law. In the Kessler matter, the bank that issued the open-end mortgage funded not only construction improvements, but also closing costs, taxes and other types of related indebtedness.

What's the big deal about that?

If you re-read the above-quoted §1508(c)(2) you'll notice that a mechanics lien is subordinate to an open-ended mortgage "the proceeds of which..." are used to pay all or part of construction improvements. Confusingly, however, the statute also identifies the "open-end mortgage as defined in 42 Pa.C.S. §8143(f)," which includes "indebtedness."

Generally speaking, therefore, an open-end mortgage need not be restricted to improvements. Specifically concerning the Mechanics Lien Law, however, whether the open-end mortgage that has priority over a mechanics lien claim is tied to whether the money is used for construction improvements.

The question for the Pennsylvania Superior Court was whether §1508(c)(2)'s priority for open-end mortgages applied only when the proceeds made part of an open-end mortgage was exclusive for improvements.

Pennsylvania Mechanics Lien Has Priority Over Bank With Open-End Mortgage Unless Lended Money Exclusively Used For Construction Improvements

The mechanics lien claimant argued that use of any portion of the proceeds for any expense other than those set forth in §1508 wholly defeats application of the lien priority exception. The bank argued opposite, that such a narrow reading of the law was impractical and contrary to the law. The Pennsylvania Superior Court, however, sided in favor of the mechanics lien claimant:

[The lender's] arguments ..disregard the clear language of §1508 and strain interpretation...We interpret the use of the term "the proceeds" to mean all of the proceeds. Indeed, we agree...that any other interpretation of the statute would permit lenders and owners to improperly manipulate the system to defeat lien rights. Such a result would be absurd and therefore contrary to legislative intent.

In Pennsylvania, the "first" to get a lien right prevails unless an exception applies. For lien claimants, their lien right actually arises when the first bit of work is performed on the project. Therefore, for a lender to beat them to the punch, they must file before any work whatsoever occurs on the project. If it is afterwards, they only get priority if the lending is part of a qualifying "open-end mortgage."

As you can see from this case, what will be a qualifying "open-end mortgage" is strictly construed and must fit within the statute's requirements. For now, Pennsylvania mechanics lien claims are that much stronger, but stay tuned to the Lien Blog in the event that this case goes up to the Supreme Court.

Read this post on the Lien Blog at:

<http://www.zlien.com/blog/?p=9350>

What It All Means: Mechanics Lien Rights Are Stronger In Pennsylvania

Lien Priority is one of those topics that is only important when it's important. In nearly 90-99% of mechanic liens filed, the priority of the lien claim is a non-issue because the claim will get paid before foreclosure and before the project runs out of money or the property out of equity. However, when money or equity is tight, lien priority can become a very big deal.

In some states, banks and lenders are always given priority over the mechanics lien claimants. In other states, the opposite occurs, with lien claimants given super priority.

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