

Question 2 – July 2018 – Selected Answer 1

(A)

Between the three parties, Liberty County has first lien position, Contractor has second, and the Bank has third. At issue here are the times that liens arise on encumbered land.

Under Texas law, a materialsman or mechanic lien can be created in two ways. Constitutionally, a mechanics' lien arises automatically upon the supply or incorporation of goods into a building or item, so long as the mechanic/materialman is in privity of contract with the owner. It is good against subsequent purchasers who have notice, but not against bona fide purchasers. If it is a homestead, the constitutional lien only arises when there is writing, signed by both spouses (if applicable), before construction begins. The lien relates back to the beginning of construction. Furthermore, there is also a statutory mechanics lien that requires filing and more requisites, but provides notice constructively to further purchasers or mortgagees. In order to have a valid statutory mechanics lien on non-residential property, an affidavit must be filed with the county clerk including: the name of the owners, contracts, subcontractors; a description of the property, and a general description of the work to be done. To be timely, it must be filed by the 15th day of the 4th month after visible work has begun. Statutory mechanics liens typically have priority over all other liens, but they are required to use judicial foreclosure rather than nonjudicial. They also relate back to the beginning of the work. There is also a requirement to give notice to the owner and other contractors, and to post notice on a website if maintained by the county.

Under Texas law, a deed of trust is a manner of securing a loan through property, and it allows for nonjudicial foreclosure by the trustee with the power to sell. Although there are various restrictions on using deeds of trust on homesteads, a deed of trust is valid so long as the formal requisites of a deed are satisfied, including being in writing and signed by the grantor. Upon default, the trustee with the power to sell may follow certain procedures to sell the property outside of the judicial process and collect on the debt.

Finally, under Texas law, county's that impose ad valorem taxes acquire liens on property upon the failure to pay taxes. These liens are exempted from the homestead protection, and they arise automatically upon the failure to pay the necessary taxes.

(1) Here, the county would have first priority because the failure to pay the ad valorem tax arose in 2015. Therefore, the county acquired an automatic lien beginning on that date. Neither the Bank's nor Contractor's interest arise back to that time. Therefore, the county would have the first lien position. (This is despite the fact that a statutory mechanic's lien typically has first priority over all other types of liens, as the commencement of work did not begin before 2015.

(2) Contractor would have second lien priority because it followed the proper procedure in setting up the mechanic's lien and its priority relates back to the commencement of work. First, Contractor started work on October 16th and filed an affidavit of commencement within the statutorily required time, as he did it "promptly." The Affidavit of Commencement is likely sufficient, although there may be two issues that are not stated here. (Typically you must file in the county clerk's office, but so long as Official Public Records of real property is the equivalent

here, that would suffice. Second, there is no indication that the property was described or a general description of the work was given. However, assuming that was done, the affidavit was sufficient.) Consequently, when the debt accrued, Contractor properly filed an Affidavit of a Mechanic's lien, and sent the requisite notices timely to Developer (as required). Therefore, the mechanic's lien would date back to the commencement of work, and the priority would be as of October 16, 2016.

(3)

The Bank is in the third lien position by nature of the timely filing. Although there is no prohibition against a party taking a lien on a property that already has liens on it, the lien takes subject to previously recorded liens or liens that priority based upon operation of law (like a mechanic's lien that relates back).

Here, Bank loaned money to Developer on February 1, 2017, after both the commencement of work by Contractor and the tax lien that arose by operation of law after failure to pay the 2015 ad valorem taxes. The Affidavit of Commencement was filed, and there was "evidence" of the outstanding tax lien. Consequently, the Bank's lien took subject to both the Contractor and County, and has the third position.

(B)

Bank may exercise a non-judicial foreclosure on the property by following certain statutory requirements. At issue here is the requirements for a non-judicial sale.

Under Texas law, a deed of trust may be foreclosed upon by a non-judicial sale. The requirements are as follows. First, the trustee with the power of sale must give notice to the debtor of the intent to effectuate a nonjudicial foreclosure. This notice must be given 21 days prior to the proposed sale. (If residential, a second notice stating the right of equitable redemption must be given 20 days prior to the 21-day notice.) This notice must be given by registered mail and include the time and place of the sale. Second, upon filing the notice, the trustee must file a notice of the sale in the county clerk's office stating the property, time, and place of sale. Third, the trustee must place a notice of the sale, with the same details, at the county courthouse. The debtor has until the time of the sale to pay off the debt, although if there is a valid acceleration clause, the debtor must pay off the entire amount of the defaulted debt. Upon the requisite filings and notices, the trustee must hold the sale at county courthouse (wherever designated by the County Commissioners or wherever specified in the notices if not designation). Further, the trustee must hold the sale on the first Tuesday of the month (unless January 1st or July 4th, in which case the first Wednesday), and the sale must occur between 10AM and 4 PM.

Here, Bank must give notice to Developer after the May 2017 default. (Since Developer cannot be found, sending it to the last address is probably sufficient.) Further, Bank must file the appropriate notices and post notice at the courthouse in Liberty County. Typically, 21 days notice is required to exercise a power of sale, but since the deed here limited the pursuit of remedies to after ten days notice, this must occur first. Consequently, Bank must give

Developer 10 days notice to cure, and then give 21 days notice of the sale information. Upon the notices and posting, Bank could hold the sale on the first Tuesday in June of 2017, at the Liberty County courthouse, between the hours of 10-4. Developer would have the right to cure within the 10 days provided in the deed, and the right to equitably redeem up until the time of the sale.

Question 2 – July 2018 – Selected Answer 2

1. Lien Superiority as Between Liberty County, Contractor and Bank

As to the superiority of liens on the property, the ad valorem taxes must be paid prior to another lienholder receiving its money provided that there is a valid tax lien affixed to the property. The second lien position would be Contractor. When a mechanic or builder engages in construction or maintenance on the property, they must first file an Affidavit of Commencement to ensure that any future lien relates back to that Affidavit. Here, the Affidavit of Commencement was filed by Contractor on or about October 15, 2016 which specified the beginning date and time. Later, when the Contractor filed the Affidavit for Mechanic's Lien in May 2017, this lien related back to the original Affidavit of Commencement and Contractor ensured its superior lien position. The third position lienholder is Bank which loaned Developer money and secured a deed of trust lien on the Property. Because Bank provided the funds for the purpose of constructing the commercial properties, its lien could be construed as a purchase-money lien but would not have superpriority over the first-in-time mechanic's lien.

2. Steps for Bank to Foreclose on Property

With respect to Bank's power of sale conferred to it under the Deed of Trust, Bank may pursue the path of non-judicial foreclosure. With commercial properties, Bank must follow a set list of procedures. First, pursuant to the Deed of Trust, Bank must provide Developer with a 10-day notice and opportunity to cure letter sent by certified mail. Because Developer cannot be found, this notice should be posted at the county location dedicated for notices and sent to the Secretary of State in the event that Developer has a business entity managing these property affairs. After the notice to cure, Bank must send a 21-day notice of foreclosure to Developer in the same manner listed above with an additional posting at the Liberty County courthouse and the location established by the County. The notice should indicate that the foreclosure will occur at the next-in-time first Tuesday of the month between 10 am and 4 pm. The notice should also be posted at the property site. In addition, Bank must provide notice to the County and the Contractor as superior lienholders of its intent to foreclose a junior interest. Any monies received from the sale would first be distributed to the County and Contractor with the remainder to Bank. Any surplus funds would be available for Developer. With these steps, the purchaser of the property would receive a Trustee Deed from Bank.

Question 2 – July 2018 – Selected Answer 3

1. The taxes have first priority on the land as valid tax liens, the contractor has a valid second lien on the property as a recorded construction and mechanics lien, and the Bank will have third priority because it had notice of the mechanics lien prior to loaning Developer the funds.

A. Tax liens have first priority.

In Texas, liens for that relate to the nonpayment of taxes on the property have "superpriority" over other preexisting liens and encumbrances. Taxes must be paid on the property or the taxing agency is able to foreclose the property with first priority and take before any validly recorded and executed mortgage or lien on the property. Here, Developer failed to pay his 2015 ad valorem taxes on the property. These constitute taxes related to the possession and ownership of the property and would have first priority over any other existing liens on the land. Therefore, the taxes have first priority over Contractor and Bank in this case.

B. Contractor has second priority.

In Texas, a mechanic and materialmen lien will have priority over a subsequent loan and mortgage on the property depending on when construction commenced. Mechanic and materialmen liens are those for the improvement, construction, and material provided for such, on the land. Such liens attach to all the land necessary for the use and enjoyment of the improvements or constructed buildings. Such liens arise at the time the parties enter into a valid construction contract and commence construction on the property. Construction is commenced at the time that visual inspection would give third parties notice of the potential rights of those providing improvements to the land. In order to maintain priority, the materialmen and mechanics must file an affidavit and serve notice on the owner upon nonpayment within three months of the date that the work is completed, the contract is abandoned, or the contractor is terminated.

Here, Developer and Contractor entered into a contract for construction on October 15, 2016 and commenced construction on the following day. In addition, the Contractor filed an Affidavit of Commencement of Construction signed by the owner and the contractor and filed such in the public records for the county. The affidavit indicated that work commenced on October 16, 2016. The loan from Bank was not taken until February 1, 2017. In addition, the Contractor validly filed an affidavit for a mechanic's lien against the property and sent the required notices to the Developer following the non-payment of the contract price. Based on these facts, the Contractor had a priority lien over the Bank, who had both record and inquiry notice of the Contractor's valid mechanic's lien and the potential that such lien would arise at the time they loaned the funds and filed the mortgage with the county recorder. Therefore, the Contractor would have second priority for the value of the work performed and not paid for in improving the land.

C. The Bank would have third priority.

As stated above, the Bank had both record and inquiry notice of the improvements and the potential mechanic's lien of Contractor since improvements had commenced at the time the Bank loaned developer the money. Based on these facts, the Bank would take priority behind both the tax lien and the Contractor's lien.

2. In order to validly foreclose, the Bank must comply with the statutory requirements for non-judicial foreclosure and the terms of the deed of trust.

In Texas, a party may foreclose a valid lien on real property through judicial or non-judicial process. Judicial foreclosure is required where the parties have not agreed to non-judicial foreclosure. A deed of trust allows the secured party to foreclose and recover through non-judicial foreclosure. The party must provide statutory notice to the parties which includes a demand for payment and warning that if such payments are not made current the property will be foreclosed, and then notice of acceleration and foreclosure of the lien. The party must post notice at the county courthouse where the property is located that the property is being foreclosed and wait at least 21 days to commence the foreclosure process. The foreclosure must occur at a specified time and place, usually between 10am and 4pm on the first Tuesday of the month and in a location assigned by the County Commissioner. Furthermore, the foreclosing party must provide the owner an opportunity to cure and exercise their equitable right of redeeming the property. The debtor must have at least 60 days to exercise such rights unless they are waived after default. Texas does not have a statutory redemption statute, therefore the party loses all rights to redeem after foreclosure sale occurs. The deed of trust may instruct additional things such as additional notice and opportunities to cure and whether the trustee or secured party may buy at the foreclosure sale. The trustee must provide notice to any junior lien holders within a reasonable time about the foreclosure, 10 days notice is presumptively reasonable. If the parties comply with these requirements, the sale is valid.

Here, Bank has third and last priority to the property. The purchaser at a foreclosure sale take free of junior liens but subject to any senior liens. Because the Bank is inferior to both the tax liens and the Contractor's liens, the Bank does not have to provide notice of foreclosure to either party. However, Bank must provide the required notices to Developer and give the Developer the right to exercise his equitable rights of redemption. In addition, the Bank is required to give the Developer an additional 10 days' written notice of and opportunity to cure the default prior to pursuing any remedies under the deed of trust. If Bank complies with all the statutory requirements and terms of the deed of trust, the sale by the trustee will be valid and the proceeds will go to discharging the Banks lien after all administrative costs are paid, both the tax lien and the Contractor's lien will remain attached and perfected against the property. If the funds are not enough, Texas allows the Bank to pursue Developer for any deficiency judgment that may be had.