



A Message from Michael Holden

August 2019

In my nine years of writing this monthly article, I have never covered the topic of Construction Disbursement. This may be a regional issue as not all states disburse construction loans to insure mortgage priority, but some do, and it is a very interesting aspect of the role of the title agent. I hope you enjoy.

Welcome to August! The month when the children head back to school and the summer rush winds up. I hope your summer was very successful.

Sincerely,

Michael Holden

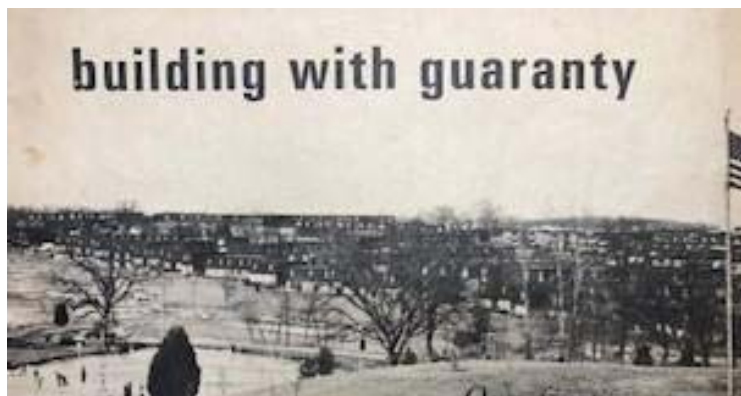
The Ramblings of a Title Man

Construction disbursement - Good deal or ordeal?

What is construction disbursement when it comes to title insurance? If you do not live in Colorado, Missouri, Virginia or Wisconsin, you may never have heard of this service. Other title agents provide this service across the United States, but it is most prevalent in the states where mechanics liens and materialmen liens can automatically take priority over construction mortgages.

In some states, a construction mortgage, even if it is recorded before work begins, fails to gain priority over mechanics and materialmen liens if the mortgage is for the purpose of paying for construction or improvement on the property. We call this "super priority," where the laborer has the right to lien and "jump" priority over the construction mortgage.

To solve this problem, lenders ask for mechanics lien coverage on their title insurance policy. Title insurance companies refuse to give such protection without some assurance that the project will be managed properly and the funds



from the construction mortgage will be paid to the persons who actually do work on the property. Some title insurance companies have obtained this assurance from a personal guarantee from the builder, or from some type of performance bond. In several states, the optimal way to ensure monies from the construction mortgage are paid to the people who actually work on the property is to have the monies disbursed by the title agent to the subcontractors directly. We call this "construction disbursement," and it is a very popular way to provide the title insurance company assurance the monies are going to the right place and a lien will not take priority over the construction mortgage.

Customs and practices vary across states, but here are the basics of how it works: First, when the construction project is ready to be closed, the builder, owner, lender and title agent enter into a construction escrow agreement. This agreement spells out the duties and responsibilities of all parties. The builder builds the home, the owner pays his percentage towards construction, the lender lends the money for construction and the title agent monitors the project, disburses the funds and issues a title policy to the lender providing coverage for mechanics liens that may take priority over the lender's mortgage. Next, after closing, the project gets underway, and each month, the builder completes a draw request showing the subcontractors who need paid for that month (carpenters, plumbers, masons, lumber suppliers, etc.) The draw is provided to the title agent, who updates the title to make sure no mechanics liens are filed and inspects the property to verify all the work to be paid for has been completed on the property. If the title is clear and the work to be paid is done, the title agent receives an advance on the construction mortgage from the lender, and then uses those funds to pay the people listed on the draw request. Lastly, the title agent will usually use an ALTA 33-06 disbursement endorsement raising the amount of insurance to the level disbursed and updating the date of the policy. It is important to remember that in most cases, the original policy issued *removes the mechanics lien exception, thus giving mechanics lien coverage to the lender*. As each disbursement is made, and the disbursement endorsement is issued, the amount insured under the policy increases, but at all times the policy insures against mechanics liens.

Disbursement of construction loans is lucrative for some title agents. My grandfather's company, Guaranty Land Title Company in St. Louis, provided this service in the 1950s and 1960s. The company disbursed major projects around St. Louis, including the apartment project known then as Seven Trails West in Baldwin, Missouri, which is pictured above. That project disbursed over \$5.5 million. Fees in the 1960s ranged from 2 to 3 percent of the total construction cost, so large disbursement projects were very lucrative. However, the risk for the title agent is also very large. Title underwriters seldom grant authority for a title agent to conduct construction escrows. For the few agents who are

permitted to practice this type of work, the **agent is responsible for all claims**. The underwriter and the agent execute a personal undertaking agreement stating that if there is a claim for mechanics liens under the policy, the agent is financially responsible for paying the claim. The liability the agent assumes makes this type of work fraught with danger, and a mistake could cost tens of thousands of dollars.

In 1966, another title agent in St. Louis was tricked into over-disbursing on a construction loan. The builder had a heating and air conditioning system installed in one house, but then moved it to three other homes, collecting a disbursement for each home - in essence, getting paid four times for the same heating and air conditioning system. Fortunately for the title agent, the scheme was discovered early, the builder was sued, and the losses were capped at the cost of the three HVAC systems. In the end, the title agent had to reimburse the title underwriter more than \$20,000 for a claims expense.

"As the builders say, the larger stones do not lie well without the lesser."

Plato, 424-348 BCE, Athenian Philosopher

DISCLAIMER: The opinions expressed herein are those of the author, Michael Holden, and do not represent any company or organization. While the information presented is believed to be accurate, it should not be a substitute for legal advice, and readers are strongly encouraged to seek independent legal counsel.

Upcoming Speaking Engagements:

October 17-19, 2019
Virginia Land Title Association
2019 Convention
"Cemeteries, Ghosts and Zombies (houses that is)!"
The Hilton Norfolk The Main
100 E Main St
Norfolk, VA 23510

November 11, 2019
Central Ohio Land Title Association
"Ethics for Title Agents and Title Attorneys"
CE and CLE for Ohio is being applied for
Columbus Library Downtown
96 S. Grant Avenue
Columbus OH 43215
www.colta614.com

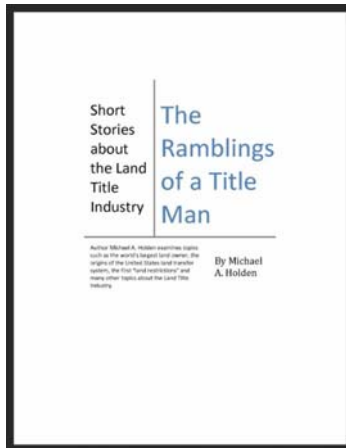
Interested in having Michael Holden speak at your land title convention? Please send me an email: Michael.holden@rocketmail.com

Topics available in 2019 are:

- Ethics for Leadership in Title Companies
- Homeowner Outreach Program
- ALTA Best Practices
- TRID Operations: Working with the Loan Estimate and Closing Disclosure
- The History of Land Titles and the U.S. Land Title System
- Cemeteries, Ghosts and Zombies
- Cyber Fraud, Wire Fraud and protection Protecting Your Agency from Today's Threats
- The Ramblings of a Title Man "Live"
- 1031 Exchanges (new in 2019)
- Remote Online Notary - how does the technology work? (New in 2019)

Other topics available upon request.

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