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MEMORANDUM

TO: ELEVENTH ANNUAL REAL ESTATE SYMPOSIUM ATTENDEES

FROM:

RE: THE IMPORTANCE OF TITLE SEARCHES AND LIEN PRIOR

DATE: May 4, 2004

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The Michigan Court of Appeals in *Advanta National Bank v Homer W. McClarty*, 257 Mich App 113, 667 NW2d 880 (2003) held that a mortgagee's lien interest in real property may be extinguished by the foreclosure of a prior construction lien even if the mortgagee was not made a party to the foreclosure action.

The moral of this story is that for any lender or person lending or acquiring an interest in real property should require that any and all liens showing against the property via a title search be discharged and final, unconditional lien waivers obtained prior to or at closing and, in any case, so called "gap" coverage should be obtained from the title company, insuring the status of title through the period from the date of execution of the note or deed and recording of the mortgage or deed.

In the instant case, Erb Lumber provided construction materials to property owned by Roderick Tennant and his wife, and filed a claim of lien on March 26, 1998. On October 2, 1998 Erb Lumber initiated foreclosure proceedings on the construction lien. The only parties named in the construction lien foreclosure were the Tennants and Plymouth Capital Company. On September 26, 1998, prior to commencement of the lie foreclosure action, the Tennants executed a mortgage with Advanta to secure a new loan. The mortgage was not recorded until October 28, 1998. On March 8, 1999 the

court entered a "Default Judgment and Judgments of Foreclosure of Construction Lien in favor of Erb Lumber, Inc." with a four month redemption period. A judicial foreclosure sale was conducted on July 19, 1999 and Erb Lumber received and recorded the clerk's deed of foreclosure. On August 19, 1999 Mr. Tennant commenced individual Chapter 7 proceedings. Advanta argued that its mortgage required them to be a party to the foreclosure action. The trial court ruled that Advanta's lien interest was extinguished.

The appellate court affirmed the trial court's decision. Advanta argued that MCL 5470.1117(4) requires that "any party who has an interest in the property at the time of filing which would be divested or impaired by the foreclosure of the lien shall be made a party to the action." the appellate court held that "substantial compliance" applies to this statute and that a lien claimant can only be required to notify every party who has a known or recorded interest. The court ruled that there is no evidence which proves that Erb Lumber followed the strict procedures of the Construction Lien Act. The court found that because Advanta's interest in the property was not recorded until after foreclosure proceedings were initiated and a notice of lis pendens filed, Advanta's lien rights were extinguished.

It was undisputed that Advanta's mortgage was recorded subsequent to the first actual physical improvements to the property. The foreclosure of a senior mortgage, including foreclosure of a lien, extinguishes the lien of a junior mortgagee or the junior mortgagee that did not redeem from the foreclosure sale. Advanta made no efforts to redeem its interest after the foreclosure sale and therefore, Erb Lumber's purchase was not subject to Advanta's junior mortgage, which was extinguished after the four month redemption period expired.

Advanta claimed on appeal that it was prejudiced by lack of notice of the foreclosure sale. However, Erb Lumber published notice of the sale on seven occasions in six different places. As the court noted, most importantly, the construction lien was recorded before the mortgage was executed and the notice of Lis Pendens was filed before the mortgage was recorded, all of which provided constructive and/or actual notice to Advanta. The court concluded that had Advanta properly checked the records and properly recorded its mortgage when it was executed, Advanta would have been made a party to the subsequent proceedings and that under the circumstances any prejudice to Advanta was brought about by Advanta's own negligence and lack of diligence.

Can there be any doubt that it is always prudent to obtain a title search and obtain "gap" coverage when entering into a loan transaction. The modest expenditure of time and money is always justified.

If you have any questions or comments regarding this decision or its practical implications, please contact me at (248) 359-6326 or by e-mail at edw@maddinhauser.com.