

## Invest a Little Time... Save a Little Money... Interested?

By Brad Meyer<sup>1</sup>

I believe Shakespeare first floated the notion of improving efficiencies by shooting someone...in his day, it was lawyers. A few centuries later, new construction lenders have their own tongue-in-cheek version of the play's opening line, discussed at 2004's Strategies for Success in Construction Lending (SSCL) seminar entitled, "Don't Shoot the Inspector."

The seminar put forward a very good case emphasizing the importance of a critical working relationship between lenders and inspection companies, but upon further review of the discussion notes, one has to wonder, "if not the inspector, then who..."

The answer for new construction lenders, of course, is to simply avoid problems with inspection results altogether through improved and closer coordination with their draw inspector partners. More specifically, a small investment of time to provide adequate information when placing an order, not only improves the efficiency and quality of the overall process, but prevents follow-up problems and actually saves the lender time...and money.

It is well accepted in the industry that the draw inspection function is a critical part of the disbursement process for residential new construction lenders. But it is also a function that plays an increasingly vital role in the lender's risk management process. Inspection companies should have the tools available to them to thoroughly understand the scope of each construction project and the impact of each inspection to the current and final valuation of the collateral. What's more, the inspection company *should* serve as a logical extension of the lender's customer service levels and relationship management.

A closer examination of these roles actually reveals ways that a lender can save manpower — and thus costs of loans — depending on how well they manage their relationship with their inspection company. The key is providing the information the inspector needs to complete a quality inspection and a little time on the lenders part while placing the order.

*continued on page 2*



## Protecting a Mortgage's Priority Over Construction Liens in Michigan

By Mark E. Hills<sup>2</sup>

This article will discuss provisions of Michigan's Construction Lien Act ("CLA"), MCL 15.1101, *et. seq.*, as they relate to the interruption of mortgage priorities by construction liens.

From a document recording perspective, Michigan is a race-notice state; a subsequent bona fide purchaser has priority over prior unrecorded interests only if the subsequent purchaser records first. In layman's terms, the first instrument regarding real estate to be recorded takes priority over later recorded instruments of whatever sort. The same standard applies to lenders and their security interests in property; a subsequent bona fide purchaser for value takes priority over the mortgagee if the mortgage is not recorded, or is not properly recorded. The priority established through a recorded mortgage on property under construction, however, remains potentially subject to construction lien claims.

The CLA is a remedial statute. It serves two purposes: protecting the rights of lien claimants to payment for

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## ***Invest a Little Time...Save a Little Money... Interested?***

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Draw inspection companies who lead the industry in contributing the most value to their lender clients are those who focus on delivering three things, in this priority order:

1. High quality, consistently accurate and reliable draw inspections
2. Fast turn times, with flexibility and “extra step” service orientation
3. Outstanding customer service — a positive extension of the lender and the overall loan experience

The first, most important ingredient to producing high quality inspections is having accurate and sufficient information about the property up front. For example:

- Is the address correct?
- Are there current phone numbers for the builder? For the borrower?
- Are floor plans or a building footprint provided?
- Is an appraisal summary provided?
- Is a cost breakdown provided?

What's more, there are even specific guidelines from NARCL (National Association of Residential Construction Lenders) that identify basic information necessary for high quality inspections. This information, and more, is essential to the inspector getting the job done right the first time, avoiding time-consuming follow-up and, most importantly, maintaining a positive experience for borrowers and builders. The real drawback to lenders, even in a flat rate fee relationship with the inspection provider, is that it will require more coordination and management time on the part of their loan personnel to deal with the follow-up. While it's very understandable that the loan administrator wants to expedite the funding request for the borrower, the rush to funding often leads to incomplete information, and the inevitable result is extra time and expense related to follow-up, increased turn times, and decreased customer satisfaction.

Multiply that extra “follow-up” time by the hundreds or thousands of loans processed by a lender, and you're talking in terms of headcount instead of overtime.

Providing sufficient and accurate information about the property at the outset of a draw inspection is the single most important responsibility of the lender to ensure quality, and fast completion and delivery. But frankly, it's not all the lender's responsibility. An inspection company who truly has the best interests of the lender at heart will follow up with the lender to alert them if vital information is missing before the inspection occurs.



Sometimes an important step in obtaining the right information needed about a property is also determining what information is relevant or not, especially with larger, more complex structures. Leading draw inspection firms usually have former home builders on staff to help determine additional information needs ahead of time, and certainly to provide additional value and quality control in the review stages of the report and delivery.

Fast turn times are a common priority objective to all parties, but especially to inspectors who often work under the pressure of knowing that other disbursement processing steps are literally waiting for the inspection report to be completed. Providing the inspector with sufficient and accurate information about the property up front is the very best way to ensure fast turnaround.

Finally, the draw inspector serves a vital role in providing the borrower with outstanding customer service. Think about it — other than the loan officer, the inspector is usually the only “face” the borrower may ever associate with the lender. The inspector also plays a pivotal role in relationship management between lenders and builders. It's the manner, knowledge, and patience on the part of the inspector that can instill confidence in the borrower and builder. It might even be the inspector's ability to listen that can make the difference between a satisfied or unhappy customer in this highly competitive business. Having accurate information and a close working relationship with the inspection company enables the inspector to do a much better job in this important category.

So time is money, and hopefully there is no need to shoot anyone in the draw inspection process. In short, investing a little time on the front end of the order, by the lender and inspection company, to get sufficient information about the property will save money for the lender and inspector in the long run. It will facilitate the highest quality, fastest completion and delivery, and most pleasant customer experience...without extra costly time for follow-up. By doing so there is no need to say, “Don't shoot the inspector.” So, I guess we're back to lawyers after all, but, if done right, there might not even be a need for them.

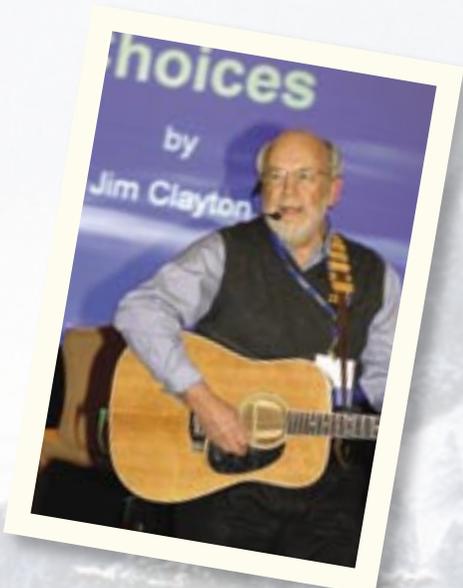
# Scenes from Strategies for Success in Construction Lending

December 7-8, 2005 • Avon, Colorado



Jim Clayton, Conrad Ricketts and Tom Daschle pose with Granite Loan Management's President, Bill Cobb.

Doug Duncan, the MBA's Chief Economist, imparts his Economic Forecast.



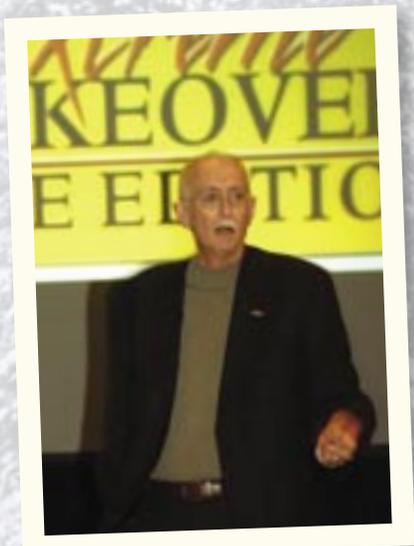
Special Guest Speaker, Jim Clayton, motivates and entertains participants.



SSCL attendees listen intently during session.



SSCL sponsor – Fair Isaac gets traffic from conference attendees.



Conrad Ricketts wows the crowd with details of Extreme Makeover: Home Edition.

Former Senate Majority Leader, Tom Daschle delivers the keynote address.



## Annual Strategies Seminar a Huge Success at Beautiful Beaver Creek

The 2005 Strategies for Success in Construction Lending (SSCL) Seminar took place this past December 7-8, at the Ritz-Carlton, Bachelor Gulch in Avon, Colorado. In attendance were over 100 leaders in the construction lending industry.

The two-day summit was highlighted by Keynote Speaker, Tom Daschle, the former Senate Majority Leader who spoke about the construction lending industry and the state of the economy in his speech "Life After Greenspan." Other session highlights included an "Interactive Discussion — Industry Regulations & Quality Assurance" moderated by Sharon Heitman and Erik Mills from the Heitman Group, Inc., "2005's Top 3 Issues and Solutions" led by Marc Lifset and David Thompson of McGlinchey Stafford PLLC, Jeff Todhunter of HomeStreet Bank, and Jim Ertle and Chris Giles of CitiMortgage. An "Economic Forecast" was given by Doug Duncan, Chief Economist for the MBA, and "International Residential Building Codes" was presented by Thomas Meyers of Colorado Code Consulting. The final session was an awe-inspiring and motivational segment entitled, "Make Over Your Community" presented by Conrad Ricketts, Senior Producer of Extreme Makeover, Home Edition. "We don't just change lives, we change futures," Ricketts enthused while detailing the vast complexities of the Emmy nominated show.

The second day highlights included Special Guest Speaker, Jim Clayton, founder and former CEO of Clayton Homes, who spoke about his incredible success as a real estate entrepreneur and later the Tennessee native generated

huge applause with a down home musical interlude. Robert MacPherson of Thelen, Reid & Priest LLP and Thomas Fritzen Jr. of Martin, Leigh, Laws & Fritzen, PC followed with an "Open Forum — Ask the Experts" segment, and the seminar concluded with "HELP! I Need Commercial General Liability or Builder's Risk Insurance!" presented by Kathleen Felderman and Brad Gibson of Lockton Companies of Colorado.



The Ritz-Carlton, Bachelor Gulch in Avon, Colorado.

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*"...the ability to meet and discuss practices with peers was priceless."*

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The 2005 SSCL Seminar was sponsored in part by Fair Isaac, First American Nationwide Documents, McGraw-Hill Construction, Northwest Construction Control, Inc., and The National Association of Residential Construction Lenders. Tom Daschle's exceptional speech set the

tone for the event while Jim Clayton, Doug Duncan and Conrad Ricketts added their detailed professionalism to make the seminar's content even more stellar than years past.

This year's conference was the 7th annual event for SSCL, which continues to celebrate its success by recruiting top-notch speakers and detailing vital information for the construction lending industry. The seminar will move to the West Coast for 2006 where it will be held on December 6-7, at The Ritz-Carlton, Laguna Niguel, in Dana Point, California.

Presented by Granite Loan Management, the seminar was founded to provide a forum in which members of the construction lending industry could gather once a year to exchange thoughts and ideas. Now one of the most successful seminars of its kind, and one of the best-kept secrets in construction lending, the two-day event continues to focus on core issues facing the industry, while highlighting up-to-the-minute topics in the ever-changing construction lending market.

To quote 2005 seminar attendee Glenn McCabe from Wells Fargo Home Mortgage, "SSCL was a great experience. The information presented was relevant and the ability to meet and discuss practices with peers was priceless."

SSCL presenter Granite Loan Management would like to thank each of this year's sponsors, speakers and attendees for making The 7th Annual SSCL Seminar a truly extraordinary event and look forward to seeing you in 2006.

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## Protecting a Mortgage's Priority Over Construction Liens in Michigan

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wages and materials; and protecting owners from paying twice for those services. Generally, the CLA provides the right to a construction lien to each contractor, subcontractor, supplier, or laborer who provides an improvement to real property. "Improvement" is defined as:

*The result of labor or material provided by a contractor, subcontractor, supplier, or laborer, including, but not limited to, surveying, engineering, and architectural planning, construction management, clearing, demolishing, excavating, filling, building, erecting, constructing, altering, repairing, ornamenting, landscaping, paving, leasing equipment, or installing or affixing a fixture or material, pursuant to a contract.*

Substantial compliance with the CLA's provisions is sufficient to establish a valid construction lien and the act is liberally construed to effectuate its purposes.

The CLA also sets forth the priorities granted to construction liens over other encumbrances as follows:

*A construction lien arising under this act shall take priority over all other interests, liens, or encumbrances which may attached to the building, structure, or improvement, or upon the real property on which the building, structure, or improvement is erected when the other interests, liens, or encumbrances are recorded subsequent to the first actual physical improvement.*

Under this section, a construction lien takes effect upon the first actual physical improvement and has priority over a mortgage interest recorded after commencement of the construction work.

The CLA then defines "actual physical improvement" as:

*The actual physical change in, or alteration of, real property as a result of labor provided, pursuant to a contract, by a contractor, subcontractor, or laborer which is readily visible and of a kind that would alert a person upon reasonable inspection of the existence of an improvement. Actual physical improvement does not include that labor which is provided in preparation for that change or alteration, such as surveying, soil boring and testing, architectural or engineering planning, or the preparation of other plans or drawing of any kind or nature. Actual physical improvement does not include supplies delivered to, or stored at the real property.*

Significantly, the first actual physical improvement does not need to be performed by the party claiming the lien. It is also significant to note that a contract for construction work need not be in writing unless the services or labor provided relate to residential construction. All construction liens are treated as having equal priority, whether they were recorded before or after the first physical improvement occurred. As a result, a subcontractor who hangs a company's sign behind its reception desk the day before an occupancy permit is issued has the same priority as the excavator who started digging the foundation on the first day of the project.

By limiting the type of improvements that qualify as actual physical improvements to those that are readily visible and would provide reasonable notice of the improvements, the CLA provides parties, such as mortgagees, an opportunity to affirmatively determine whether their interests or potential interests in the property may lose priority to construction lien claims.

A lender's knowledge of improvements or planned improvements does not preclude it from recording its mortgage and taking priority over a construction lien if its mortgage is recorded before the first actual physical improvement. Accordingly, even if the lender knows that blueprints have been prepared that would entitle an architect to a construction lien because the preparation of such plans are an *improvement*, the lender's mortgage will still take priority as long as it is recorded before the first actual *physical* improvement takes occurs.

Not all actual physical improvements may put a lender on notice of the existence of potential construction lien claims. As noted by McAlpine & Keating<sup>3</sup> in their review of Michigan construction lien law, soil boring, which does not qualify as a first actual physical improvement, and well digging, which might satisfy the definition, are difficult to distinguish. Because such potential problems exist, it is imperative that a lender positively determine whether work has actually begun on site and take all steps necessary to insure that its mortgage is recorded before any actual physical improvements are allowed to commence.

<sup>3</sup>Keating, Patrick J., and McAlpine, Mark L., *Construction Liens in Michigan*, The Institute of Continuing Legal Education, Ann Arbor (1996), § 3-3.



Mark E. Hills

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#### Construction-at-a-Glance

|                               | Oct. 04 | Oct. 05 |
|-------------------------------|---------|---------|
| Total Monthly Housing Starts* | 2,062   | 2,014   |
| YTD Permits-Single Family*    | 1,384   | 1,443   |
| Monthly New Home Sales*       | 1,424   | 1,306   |
| Unemployment Rate             | 5.5%    | 5.0%    |

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