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NEW AMENDMENTS TO THE PENNSYLVANIA MECHANICS' LIEN LAW ATTEMPT TO CLARIFY WHEN WAIVERS OF LIEN ARE PERMISSIBLE

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The Real Estate and Institutional Finance Practice Group and the Construction Practice Group of White and Williams LLP have extensive expertise in the area of mechanics' liens and have been monitoring the various proposals to amend Pennsylvania's Mechanics' Lien Law of 1963 (the Lien Law).

In 2007, there were extensive amendments made to the Lien Law that severely limited the permitted use of pre-construction, pre-payment waivers of lien rights. This was a major change in the relationships between owners, lenders, title insurers, contractors and subcontractors, and how lenders and owners sought to protect projects from mechanics' liens. One of the few situations in which a contractor or subcontractor could waive its right to file a mechanics' lien was when work was performed on a "residential building" with a total contract price of less than \$1 million. However, there has been confusion centering around the definition of the term "residential building." Additionally, the 2007 amendments permitted a subcontractor (but not a contractor) to waive its lien rights for both residential and non-residential projects regardless of the size of the contract between the owner and contractor *provided* that the contractor posted a bond guaranteeing payment for the labor and materials provided by the subcontractor.

The 2009 amendments, which go into effect on October 12, 2009, amend the Lien Law to, among other things, redefine the type of residential property for which a waiver of liens will be effective. Under the 2007 amendments to the Lien Law, "residential building" was defined as a "property on which there is a residential building, or which is zoned or otherwise approved for residential development, planned development or agricultural use, or for which a residential subdivision plan or planned residential development plan has received

preliminary, tentative or final approval . . ." Because of the confusion created by this definition, there was debate as to whether large-scale projects, including apartment buildings, condominium developments, and mixed residential-commercial development projects, would be considered a "residential building" so that waivers of liens could be validly executed and filed.

The 2009 amendments to the Lien Law revise the definition of "residential building." The amended Lien Law now refers to "residential property," not "residential building," and defines "residential property" as "property on which there is or will be constructed a residential building not more than *three stories in height*, not including any basement level . . ." It also removed the \$1 million limitation. As to residential projects, this new definition of "residential property" reflects the legislative intent that the permissible waiver of contractor's and subcontractor's mechanics' lien rights should be limited to the construction of single-family homes and other limited-size residential buildings, regardless of cost.

On and after October 12, 2009, pre-construction, pre-payment lien waivers **will be effective** for:

- Contractors on a "residential property" (a residential building of three stories or less regardless of cost);
- Subcontractors on a "residential property" (a residential building of three stories or less regardless of cost);
- Subcontractors on non-residential projects if a payment bond is posted by the contractor.

Pre-construction, pre-payment waivers **will not be effective** for:

- Contractors on non-residential projects (whether or not a

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payment bond is posted);

- Contractors and subcontractors on residential buildings that are not “residential properties” (that is, buildings over three stories in height).

Unfortunately, the amended statute also creates some ambiguities and inequities. For example, a four-story townhouse or a five-story building with two condominium units per floor would not be considered “residential property,” and the purchasers of these properties could not be protected by a waiver of liens by the contractor under any circumstances. By contrast, an owner can validly insist as part of its construction contract that the contractor and its subcontractors waive their lien rights on a \$10 million ranch home as long as the house is not more than three stories tall. Also, since a “planned residential development” under the Pennsylvania Municipalities Planning Code can include a “combination of residential and nonresidential uses,” does a two-story building in such a development that has commercial units on the first floor and residential apartments on the second floor qualify as a residential property or a non-residential property under the amended Lien Law? The answer under the new amendments is not clear. Thus, while the changes to the Lien Law do eliminate some ambiguities caused by the 2007 amendments (especially through the use of a “three-story” bright line test), there still remains many gray areas in the new law

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