Homeowners Denied Equitable Lien on their Property

by

James R. Keller

This article appeared in *St. Louis Construction News and Review*, p. 22-23, January-February, 2011.

Purchasers of a new home learned the hard way the risk of putting money into a residence that they did not yet legally own. The Western District of Missouri affirmed a trial court's decision to deny Ivan and Marie Johnson of recovery of $102,000 for money they spent and advanced for construction of their new residence.

The case is *First Banc Real Estate, Inc. v. Johnson*, 321 S.W.3d 322 (Mo. App. W.D. 2010). As the Western District noted, this "case is illustrative of the pitfalls and landmines inherent in residential construction when financial risks are perilously undertaken by purchasers who lack an appreciation of the complexities of real estate law." *Id*. at 325.

The Johnsons had entered into a residential new construction sale contract with Sanctum, LLC, a company that had acquired a tract of land for the purpose of platting the Longview subdivision in Lee's Summit, MO. To acquire the property, Sanctum obtained one by one three construction loans from Gold Bank totaling more than $2,790,750, each loan being secured by a deed of trust on all the properties that comprised the subdivision.

The construction contract required Sanctum to construct a residence for the Johnsons. Sanctum was then to sell the property to the Johnsons for $317,600. Sanctum was both the seller of the property as the owner of the legal title and the builder obligated to construct the residence.

The construction contract provided agreed-upon options, finish allowances and a schedule for completion. Sanctum and the Johnsons agreed that the Johnsons could purchase some of the materials needed to construct the residence and hire third parties to perform some of the work.

The Johnsons and Sanctum agreed that the cost for materials and labor provided by the Johnsons would be credited against the purchase price. This arrangement was not put in writing.

During construction, the Johnsons purchased materials and paid for labor in the amount of $57,517.86. They also paid Sanctum an earnest money deposit in the amount of $62,720, as an advance payment to be applied toward the total purchase price.

During construction Sanctum obtained a loan from First Bank of Medicine Lodge (FBML) in the amount of $525,000. A deed of trust secured the loan. Gold Bank did not release any of its original deeds of trust.

The construction contract required the Johnsons' residence to be completed by November 15, 2002. Through numerous delays the first closing was not scheduled until nearly one and one-half years after the original promised completion date. The Johnsons began moving personal items into the residence in anticipation of the closing, but the closing did not occur. Thereafter, numerous new closing dates were scheduled but not met. Title to the property was never transferred to the Johnsons.

Gold Bank proceeded to foreclose on its second deed of trust. Immediately prior to the foreclosure, the Johnsons filed a notice of equitable lien against their property, claiming an equitable lien in the amount of $102,000.

Gold Bank was the only bidder at the foreclosure sale. Through an assignment First Banc Real Estate, Inc. (FBRE) became the owner. To protect their interests, the Johnsons sent a notice of mechanic's lien to Sanctum, Siena Development, LLC and FBML, of which FBRE was a subsidiary.

The Johnsons' mechanic's lien was for $121,237.68. The lien consisted of $63,720 that the Johnsons had paid Sanctum and $57,517.86 for labor and materials that otherwise would have been provided by Sanctum.

Several other subcontractors also filed mechanic's liens on the property. All liens were consolidated into one lawsuit and resolved except for the Johnsons' claim, which proceeded to trial.

The Western District concluded that the Johnsons were not eligible to be lien claimants for they were neither an original contractor nor a subcontractor for they were in fact equitable owners of the property.

The Western District held that the Johnsons had a valid equitable lien against the property in the total amount of $121,237.86. Where an equitable lien pre-dates a deed of trust, the equitable lien survives a foreclosure. In this case, however, the Johnsons' equitable lien arose after Gold Bank's second deed of trust, the one on which the foreclosure took place. Thus, it was wiped out by the foreclosure.

This result left the Johnsons without any ability to recover on its lien claim and created a "windfall" for FBRE. *Id*. at 337. "That is not a result that sits well with the Court, but it is a result that is required by the law as the Court interprets the law." *Id*. While recognizing the "unfairness of the outcome," the Western District concluded that the law left it with no alternative.

James R. Keller is a partner at Herzog Crebs LLP where he concentrates his practice on construction law, complex business disputes, real estate and ADR. He also is an arbitrator and a mediator.