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Mechanic's lien protection for commercial landlords: the lease

Colorado maintains a very strong mechanic's lien statute designed to ensure that construction and design professionals receive the payments to which they are entitled. *(See, Colo. Rev. Stat. §38-22-101, et. seq.)*

Generally, anyone who performs services or labor, or provides materials on a construction project, is entitled to a lien against the subject property to secure payment of the amounts to which he is contractually entitled. The statute defines the parties entitled to a mechanic's lien very broadly. It includes laborers, architects, engineers, contractors, subcontractors and anyone who provides materials to a project.

Although there are strict deadlines by which a prospective lien holder must serve a notice of intent to file a lien and then record it, the process is relatively simple and it is not uncommon for a party to file a lien even if there are legitimate disputes over the quality of the work performed or the amounts owed.

The filing of a mechanic's lien against property can create major problems with secured lenders. Even if the lien is ultimately found to be invalid, litigating that issue typically takes many months and the lien remains a cloud on property title during that period. In most cases, the only way to remove the lien during the pendency of litigation is to file a cash or surety bond in the amount of 150 percent of the claimed lien.

Typical commercial loan documents provide that the filing of a mechanic's lien against the secured property is an event of default if the lien is not removed within a certain period of time (typically 30 to 45 days).

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Of concern in the commercial leasing arena is the encumbrance of the fee interest of the property by a mechanic's lien, even if the work is repair or finish work being commissioned by the tenant. Absent some relatively simple steps, even if the work is only tenant finish work, a mechanic's lien will encumber not just the leasehold interest, but the fee interest as well. Even if the tenant has fully paid its general contractor, the subcontractors and material suppliers may still file a lien if the general contractor has not paid them what they are owed. As mentioned above, that is likely to trigger an event of default under the secured financing documents.

Fortunately for landlords, a provision of the Colorado mechanic's lien statute allows a landlord to serve and/or post a notice of nonresponsibility for payment of construction commissioned by a tenant.

Colo. Rev. Stat. §38-22-105(2) allows a landlord, within five days after knowledge of the construction, to personally serve on any potential lien claimant a notice that the landlord will not be subject to any lien. Alternatively, a landlord, within five days of knowledge of the construction, may post a notice of nonresponsibility in a conspicuous space within the premises under construction.

It is more common for landlords to post a notice on the property rather than personally serving contractors and subcontractors – primarily because it is easier. On a significant project, a combination of the two methods is most effective. That is, the general contractor and known significant subcontractors should be served with notice and the property should be posted with a notice.

To successfully defend a lien claim by posting a notice, the landlord or its property manager must be vigilant. The statute requires that the notice be posted in a conspicuous place. In the case of new construction under a ground lease, that would be at the construction entrance. In the case of tenant finish to existing space, notice should be posted both at the main entrance to the premises and at any other location on the premises to which materials are delivered. The statute also requires that the notice remain continuously posted for the entire project.

Although the posting issue would seem to be straightforward, disputes about it are very common. If a notice is posted without real-time evidence of posting and forgotten, it can be difficult for a landlord to prevail on its defense of a lien claim. Construction professionals have argued that no notice was posted, that it was posted and then torn down, or that the posting was not conspicuous and wasn't seen.

A few simple measures can reduce the possibility of these issues arising. First, when a notice is posted, there should be photos taken of the postings and affidavits signed by the people doing the postings as to the date and time of the postings. Second, a landlord's representative should visit the site every few days, take additional photos and keep a checklist of the times and dates of the inspections. Finally, to avoid an argument that the notice wasn't seen, the notice should be enlarged. It is typical to have notices blown up to three feet by two feet and mounted on pasteboard. If the notice will be posted outside, it is also a good idea to have it lacquered for weather protection.

To get the most benefit from these protections, landlords should ensure that several provisions are included in their commercial leases. First, the tenant should be required to notify and obtain the consent of the landlord before any construction begins and, if feasible, provide a list of everyone who will be working on the project. Second, the lease should provide that the recording of any liens against the property resulting from work commissioned by the tenant will be an event of default if not removed within a relatively short period of time. This will give the tenant an opportunity to bond over the lien. Third, the tenant should indemnify and hold harmless the landlord for any claims or liens arising from work commissioned by the tenant. Finally, the lease should expressly provide that the landlord has the right to post notices of nonresponsibility on and about the premises.

This provision of the Colorado mechanic's lien law is one of the few that favor property owners rather than construction professionals. With a bit of diligence, it can provide strong protection to landlords.▲