



Residential Construction Projects

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Welcome!
Residential Construction Projects
by Bill Pratt

Note: Materials for the January webinar are available at
www.stewarttexas.com (no audio available, sorry)

House Keeping

- **Please do not place the conference on hold!** Background/hold music makes it difficult to hear the speaker
- **Please mute your phones!** We are voice recording the conference. If you don't have a mute button on your phone try *6 to mute and un-mute your phone.



Homestead issue

When insuring a residential construction project our greatest concern is making sure that that any lien is created in accordance with the requirements of the Texas Constitution and Texas statutes. If the lien isn't created in compliance with the law, it may be completely invalid. How to analyze the situation and how to advise the parties to proceed requires us to fully understand exactly what the issues are and how we may be able to work around them.

A. The Constitutional Limitations: Article XVI, Section 50

- (a) The homestead of a family, or of a single adult person, shall be, and is hereby protected from forced sale, for the payment of all debts except for:
- (5) work and material used in constructing new improvements thereon, if **contracted for in writing**, or work and material used to repair or renovate existing improvements thereon if: (Emphasis added)



The Constitutional Limitations:

- 1. "Contracted for in writing" means the agreement must include:
 - a. conditions of the agreement,
 - b. nature of the improvements to be built,
 - c. character of materials to be provided and
 - d. cost of the work.

B. The Texas Property Code: Section 53.254 HOMESTEAD.

- (a) To fix a lien on a homestead, the person who is to furnish material or perform labor and the owner must execute a **written contract setting forth the terms of the agreement**.
- (b) The contract must be **executed before the material is furnished or the labor is performed**.
- (c) If the owner is married, the contract must be **signed by both spouses**.
- (d) If the contract is made by an original contractor, the contract inures to the benefit of all persons who labor or furnish material for the original contractor.



Texas Property Code

(e) The **contract must be filed with the county clerk** of the county in which the homestead is located. The county clerk shall record the contract in records kept for that purpose. (Emphasis added)

1. Written contract between contractor and owner
2. Executed before labor or material furnished
3. Executed by both spouses if married
4. Contract must be filed with the county clerk, but there is no requirement the contract be filed before work is done or material furnished



House Bill 1038

On September 1, 2007 House Bill 1038 amended sections of the Texas Local Government Code and the Texas Property Code. The amendments expanded the coverage of the Texas Residential Construction Commission (TRCC) Act. The TRCC requirements now cover:

- 1. New home construction
- 2. Improvements to an existing home that increase or decrease square footage and modify the foundation, exterior walls, or roof, but excluding replacement or repair of the roof
- 3. Interior improvements to an existing home for over \$10,000



Property Code Section 420.002

REQUIRED CONTRACT PROVISIONS:

- In a contract for the construction of a new home or an improvement to an existing home required to be registered under Section 426.003, the contract is not enforceable against a homeowner unless the contract:
 - (1) contains the builders' name and certificate of registration number, and
 - (2) contains the notice required by Section 420.001.



Property Code Section 420.001

Sec. 420.001. REQUIRED WRITTEN DISCLOSURE. In a contract for the **construction of a new home or an improvement to an existing home** required to be registered under Section 426.003, the contract **must contain** a notice to the consumer in at least 10-point bold type or the computer equivalent that gives the telephone number of the commission and states:

- STATE LAW REQUIRES THAT A PERSON HOLD A CERTIFICATE OF REGISTRATION FROM THE TEXAS RESIDENTIAL CONSTRUCTION COMMISSION IF THE PERSON CONTRACTS TO CONSTRUCT A NEW HOME OR IF THE PERSON CONTRACTS TO CONSTRUCT A MATERIAL IMPROVEMENT TO AN EXISTING HOME OR CERTAIN IMPROVEMENTS TO THE INTERIOR OF AN EXISTING HOME AND THE TOTAL COST OF THE IMPROVEMENT IS \$10,000 OR MORE (INCLUDING LABOR AND MATERIALS).



Sec. 420.001 Continued

YOU MAY CONTACT THE COMMISSION AT [insert commission's telephone number] TO FIND OUT WHETHER THE BUILDER HAS A VALID CERTIFICATE OF REGISTRATION. THE COMMISSION HAS INFORMATION AVAILABLE ON THE HISTORY OF BUILDERS, INCLUDING SUSPENSIONS, REVOCATIONS, COMPLAINTS, AND RESOLUTION OF COMPLAINTS.

- THIS CONTRACT IS SUBJECT TO CHAPTER 426, PROPERTY CODE. THE PROVISIONS OF THAT CHAPTER GOVERN THE PROCESS THAT MUST BE FOLLOWED IN THE EVENT A DISPUTE ARISES OUT OF AN ALLEGED CONSTRUCTION DEFECT. IF YOU HAVE A COMPLAINT CONCERNING A CONSTRUCTION DEFECT YOU MAY CONTACT THE COMMISSION AT THE TOLL-FREE TELEPHONE NUMBER TO LEARN HOW TO PROCEED UNDER THE STATE-SPONSORED INSPECTION AND DISPUTE RESOLUTION PROCESS



The Escape Hatch

A. It's not their homestead and we do not need to comply with the Texas Constitution or Section 53.254 of the Texas Property Code to create a valid lien. If the house is a "starter" home, this is unlikely, but the higher the construction costs, the more likely it is that they already have another home.

1. Own another house in Texas
2. Occupy another house
3. Obtain a designation and disclaimer of homestead





Fun with the Rate Rules

Rate Rule R-13: Mortgagee Title Policy on Interim Construction Loan (Binders)

- Rate Rule R-5: Simultaneous Issuance of Owner and Mortgagee Title Policies
 - R-5 A: Pre-construction policies with a credit for an existing Owner Title Policy
 - R-5 C: Post-construction policies with a credit for an existing Owner Title Policy



Fun with the Rate Rules

- Rate Rule R-18: Creation of New Loan Contemplated by Construction Lender ("Going to Perm")



R-13: Binders

The changes to Procedural Rule P-16 have limited the use of binders. They can now only be issued for construction loans that do not include the execution of a mechanic's and materialman's lien contract and where the **owner, contractor and obligor** on the debt are all the same. The charge for a Binder is minimum policy Basic Premium Rate (\$229). Binders are good for one year and up to 6 extensions for 6 month periods can be purchased for \$25 per extension. There is no prohibition on purchasing these extensions up front.

- To sum it up: **BINDERS ARE FOR BUILDERS**



R-13 Binders Continued

- A credit of 50% of the cost of the binder is authorized where:
 - 1. A new Mortgagee Policy is issued on a loan that takes renews and extends or satisfies a lien already covered by a binder, or
 - 2. A new Owner Policy is issued on a sale of the property, and the lien covered by the binder is released prior to or simultaneously with the sale.
- The subsequent policy has to be issued within one year of the original binder to qualify for the credit.
- Binders can cover multiple lots, but only one credit can be given per binder
- The credit can only be given if the property is one to four family residential



Rate Rule R-5A: Pre-Construction

Rate Rule R-5A provides for what is sometimes referred to as an “up-front” construction loan. The first part of the paragraph provides for the basic simultaneous issuance rate. But the second part, appearing in parentheses, provides that if the new Owner Policy is to include the cost of contemplated improvements (Procedural Rule P-8a) and an Owner Policy has been issued to the current owner, covering the identical property, and within the last 4 years, a credit on the new Owner Policy shall be given for the amount of premium paid for the existing Owner Policy and the Mortgagee Policy shall be issued for \$100, plus endorsements. There is no requirement the prior policy has to have been issued by the same agent or underwriter and there is no requirement the prior policy has to be surrendered.



Rate Rule R-5 A: Example

Insured has a \$50,000 Owner Policy issued in 2004. Insured currently owes \$30,000 on a purchase money deed of trust. Insured is going to sign a \$200,000 mechanic’s and materialman’s lien contract with a builder for a new home. This lien will be assigned to a lender that will be making a \$230,000 loan renewing and extending the existing purchase money deed of trust and the construction contract. The Owner Policy will be issued for \$250,000, land cost (\$50,000) plus cost of contemplated improvements (\$200,000). The premium for the Owner Policy will be \$1141 (\$1644 - \$503). The premium for the Mortgagee Policy will be \$100, plus endorsements.



Rate Rule R-5 C: Post-Construction

Rate Rule R-5C provides for the simultaneous issuance of an Owner Policy and a Mortgagee Policy with a credit for an existing Owner Policy after completion of improvements. This rule appears to have been an effort to extend the credit for an existing Owner Policy to Insureds that did not purchase “up-front” policies under R-5A, but instead acquired binders. It pre-dates the limitations on the issuance of binders and the changes to Procedural Rule P-16 appear to have made this section almost useless.

- Application of this section required the existing Owner Policy not contain any exceptions for construction (Procedural Rule P-8), be done after completion of improvements, be done only on “residential property” (not “residential real property”), the existing Owner Policy cover the identical land, be issued within 4 years of the date of the existing Owner Policy, and that there had been no change in ownership. This section does require the existing policy be “turned in” (Don’t blame me, I just read them).



Rate Rule R-5 C Continued

The problem with using Rate Rule R-5 C is that although the owners do get a credit for an existing owner title policy, they do not get any sort of credit for the construction loan mortgagee title policy they purchased. And the construction loan typically exceeds the land’s purchase price.



Rate Rule R-18: Going into Perm

When a Mortgagee Policy is to be issued on a loan which renews and extends or satisfies a construction loan covered by an existing Mortgagee Policy, the premium for the new Mortgagee Policy will be the greater of minimum policy Basic Premium Rate (currently \$229) or the difference between the basic rate for the existing Mortgagee Policy and the basic rate for the new Mortgagee Policy, plus endorsements.



Rate Rule R-18: Examples

A \$230,000 construction loan is covered by an existing Mortgagee Policy. A new loan renewing and extending the construction loan will also be for \$230,000. Premium will be \$229 plus endorsements.

- \$200,000 construction loan is covered by an existing Mortgagee Policy (premium of \$1,377). A new loan will renew and extend the construction loan and an existing land loan \$30,000 into a new loan of \$230,000 (premium of \$1,537). The premium will be \$229 plus endorsements. The difference between the premium for the new loan and the premium for the construction loan is \$160. Since this is less than the minimum policy Basic Premium Rate, \$229, the minimum policy Basic Premium rate is charged.



Any Questions???

POSSIBLE NEW DIAL IN



- We are in the process of possibly making some changes to the webinar process. One of the benefits of these changes will be better audio feed on our website. If these changes occur in the next few weeks, there will be a new dial in number beginning in March. I do not know the number yet but it will be posted at www.stewarttexas.com and the prompter will guide you when you log in to webex to use the correct phone number. (Passcode may or may not change.) To view updates/progress on these changes please visit www.stewarttexas.com.
- Thank you all for your patience as we work hard to improve the quality of the Texas TIPS online!



Thank you!

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