

Real Estate Law Update January 2015

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TABLE OF CONTENTS

[Act 117 Brings Significant Changes to Mechanic's Lien Law](#)

[Selling or Buying a Home? You Should Understand Pennsylvania's Real Estate Seller's Disclosure Law](#)

[Disclosing a Murder Under PA Disclosure Law Not Required Says the PA Supreme Court](#)

Act 117 Brings Significant Changes to Mechanic's Lien Law

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Related Practice Area: Real Estate

Related Industry: Construction

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Over the summer, Governor Corbett signed into law Act 117 of 2014 (the "Act"), which brings two significant changes for contractors to the Mechanic's Lien Law of 1963.

First, subcontractors are now prevented from filing a mechanic's lien against a residential property if the owner of the property paid the general contractor. The term residential property is broadly defined to include both the principal residence of the owner and a 1-2 unit rental property. This provision appeared to have bi-partisan support, but the practical effect may be limited as a result of the current ability of a contractor to record a stipulation against liens in connection with residential projects.

Second, the Act makes construction lending easier by fixing the problem which was created by the Superior Court's decision in *Commerce Bank Harrisburg/NA v. Kessler* in 2012. In *Kessler*, the Superior Court held that for a bank's open-end mortgage to have priority over a mechanic's lien which became effective prior to the recording of the mortgage, 100% of the proceeds of the loan secured by the mortgage needed to be used for hard construction costs. A mechanic's lien has priority from the visible commencement of construction on the property. Under the Act, if at least 60% of the proceeds of the loan secured by the mortgage are used for "costs of construction", which is broadly defined to include both hard and soft costs, the bank's mortgage will be given priority over a mechanic's lien which arose prior to, but was filed after, the bank's mortgage.

The change to the open-end mortgage statute in the Act should make construction lending easier for developers. Due to the *Kessler* case, banks have broken mortgages that ordinarily would have been a single mortgage into two mortgages, one for hard costs and one for soft costs, so the bank could be assured that its first mortgage for hard costs will receive priority over mechanic's liens. Due to fear of mechanic's liens where construction started prior to recording the mortgage they were insuring, title companies have also required

developers and general contractors to sign indemnity agreements and provide financial information so the title companies could determine the value of the indemnities. The uncertainty caused by Kessler has caused headaches for contractors, banks, developers and title companies that the Act should go a long way towards curing.

Unfortunately, while the title companies waited for the House of Representatives and Senate to pass the Act, the Title Insurance Rating Bureau of Pennsylvania (TIRBOP) revised its rating guidelines and created new endorsements which carry significant additional costs to developers. Hopefully, TIRBOP will revise these rates and its policies in light of the Act to reflect the certainty that the Act should provide relating to the construction mortgages that title companies are insuring.

[Back To Top](#)

Selling or Buying a Home? You Should Understand Pennsylvania's Real Estate Seller's Disclosure Law

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When buyers encounter problems with a recently purchased house, understanding the rights and obligations imposed by Pennsylvania's Real Estate Sellers Disclosure Law ("Disclosure Law") can be critical. The Disclosure Law imposes a duty on sellers to disclose past issues encountered at their property and provides buyers a potent remedy for undisclosed material defects on the property. Under the Disclosure Law "any seller who intends to transfer any interest in real property shall disclose to the buyer any material defects with the property known to the seller by completing all applicable items in a property disclosure statement ."

Sellers are required to completely fill out a detailed form that provides information about past incidents of water infiltration, termites and pests, additions and alterations and many other features of the property and house, and provide it to potential buyers. Further, real estate agents have a duty to ensure that the buyer receives a completed seller's disclosure and that the seller provides the buyer with a completed seller's disclosure.

When buyers encounter issues with a property that are inconsistent with the disclosures made by the seller, they may be able use the Disclosure Law to recover damages against the seller. An example of a Disclosure Law claim is where a seller states on the disclosure that the house has never had any water infiltration or flooding issues, but the buyer finds out after purchasing the house that it floods every time there is a heavy rain. The Disclosure Law, however, is not the only remedy available. Buyers can also assert claims for fraudulent misrepresentation. In the context of sales of residential property, the seller can commit fraud by making a knowingly false statement, intentionally concealing facts with the intent to deceive, or by a non-privileged failure to disclose certain facts to the other party. Additionally, a buyer could pursue claims against the seller for undisclosed conditions under Pennsylvania's Unfair Trade Practices and Consumer Protection Law, and potentially for breach of contract.

While buyers can sue sellers for fraud and violation of the Pennsylvania's Unfair Trade Practices and Consumer Protection Law based on misrepresentations, those claims require the buyer to prove that the

seller knowingly made a false statement by clear and convincing evidence. The disclosure law, on the other hand, allows buyers to recover damages by proving only that it is more likely than not that the seller knew or had reason to know that the information in the seller's disclosure was false or misleading. Where the seller willfully or negligently fails to follow the Disclosure Law, they can be found liable for the amount of actual damages suffered by the buyer. Because the Disclosure Law decreases the burden of proof for buyers, it provides a potent claim for buyers suffering from the impacts of undisclosed conditions at their property.

Sellers must completely fill out the disclosure form and ensure that information provided is accurate. Failure by a seller to fill out the required disclosure form is a violation of the Disclosure Law that could result in liability. Home owners should keep records of repairs performed to their property so they can provide accurate information about the condition of the property when they go to sell the property. Repair records will provide buyers assurance that any issues identified on the seller's disclosure were properly remedied. Where sellers are unable to demonstrate adequate repairs of identified issues, it may impact the price of their house or their ability to quickly sell the house. Alternatively, where sellers fail to disclose prior issues on the seller's disclosure form, they could face a costly suit for violating the Disclosure Law as well as for fraud, violation of Pennsylvania's Unfair Trade Practices and Consumer Protection Law, or breach of contract.

[Back To Top](#)

Disclosing a Murder Under PA Disclosure Law Not Required Says the PA Supreme Court

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In the last couple editions of our *Real Estate Law Update* ([March 2013](#) and [June 2012](#)), we had been reporting on the case of *Milliken v. Jacono*, which contemplated whether a murder/suicide at a home was a "material defect" requiring disclosure under the Pennsylvania Real Estate Seller Disclosure Law ("Disclosure Law"). Both the trial court and the appellate court held that such disclosure is not required under the Disclosure Law. However, the buyer appealed the decision to the Pennsylvania Supreme Court. In its decision rendered on July 21, 2014, the Pennsylvania Supreme Court affirmed the decisions of the lower courts.

In this case, the buyer, Janet Milliken, sued the sellers, the Joconos, as well as their real estate agents and brokers, alleging that a murder/suicide should have been disclosed to her when she bought the home. In 2006, the prior owner of the house had shot and killed his wife and himself in the house. The murder/suicide was widely publicized in the local media and the Internet. The Joconos, who knew about the murder/suicide, bought the house later that year at auction for \$450,000 -- they renovated it and then listed it nine months later after the purchase. The Joconos and their broker had done their homework by speaking with representatives at the Pennsylvania Real Estate Commission and seeking advice from the Pennsylvania Association of Realtors Legal Hotline, and both determined that the murder/suicide was not a material defect requiring disclosure. Accordingly, the sellers did not disclose the murder/suicide on the Seller Property Disclosure Statement.

The buyer who lived in California viewed the property and received a copy of the disclosure statement and entered into an agreement of sale for the house at a purchase price at \$610,000. She received homeowner's association documents, which still listed the prior owner as the owner of the house, and read the title report, which also listed the prior owner of the house. Although she questioned the large difference in her purchase price compared to what the Joconos paid, she did not investigate the matter any further after her realtor suggested that there may have been a possible mortgage foreclosure. She went forward with the purchase. She later learned about the murder/suicide from a neighbor. In the lawsuit, she claimed various paranormal events transpired at the house and provided reports from real estate appraisers showing a decrease in the value of the home between 10% to 15% as a result of the murder/suicide.

This matter was a first impression before the Pennsylvania Supreme Court. The Court focused on whether the murder/suicide could be considered a "material defect". Despite the buyer's arguments that a psychological stigma such as a murder/suicide could impact the value of a home, the Court was unwilling to find that such an event is a material defect. The Disclosure Law defines a "material defect" as *"a problem with a residential real property or any portion of it that would have a significant adverse impact on the value of the property or that involves an unreasonable risk to people on the property. The fact that a structural element, system or subsystem is at or beyond the end of the normal useful life of such a structural element, system or subsystem is not by itself a material defect."* The Disclosure Law requires sellers to disclose material defects relating to such items as plumbing, termites, electrical, roof and title. Even though the realtor's form of the Disclosure Statement, which was used by the Joconos, went beyond the basic requirements of the Disclosure Law, the Court was unwilling to accept that a psychological event was required to be disclosed.

Concerned with a slippery slope, the Court stated that defining all traumatizing events requiring mandatory disclosure would be a "Sisyphean task". (In Greek mythology, Sisyphus was a Greek king punished for deceitful behavior by being forced to roll, repeatedly, a large boulder up a hill only to have it roll back down, again and again.) The Court further exemplified the problem by asking whether a "bloodless death by poisoning or overdose" should be a less significant "defect" compared to a "bloody death from a stabbing or a shooting" and whether a rape, assault, child abuse or home invasion also be defined as a material defect. While the Court recognized that a certain percentage of the population would not want to live in a house where such traumatic events occurred, such events would not affect the structural condition of the property itself. The Court also recognized that over time such graphic events could even transform these homes into "historical curiosities", thereby even increasing their value. In the end, the Court suggested that if such events are to be considered a material effect requiring disclosure, then the legislature should provide a clear definition in the law after careful consideration of the ramifications of the issue. Until such legislation occurs, sellers can be assured that "purely psychological stigmas" such as murders and suicides are not required by law to be disclosed to prospective buyers.

[Back To Top](#)