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MINUTES OF HEARING OF JOINT COMMITTEES - ASSEMBLY AND SENATE - Feb. 23, 1965

Meeting was called to order at 2:15 P.M. by Mr. Close, Chairman of Assembly Committee on Judiciary.

Assembly Committee Members Present: Close, Parsons, Kean, Olsen, Rosaschi, Knisley, Delaney, Jacobsen

Absent: Swobe

Subject of the hearing was AB 294.

Mr. Miles, an Attorney At Law from Las Vegas, was the first proponent to speak for the bill. He made the following points:

The reason for the introduction of this bill is that now the priority of first deeds of trust wipes out the mechanics liens. Presumably no lender would enter into an agreement to lend money for a building with short monies.

The primary purpose of this legislation is to make sure that at the outset of the loan and the construction that there is sufficient funds, according to the instrumentations in the file, to build out the project and pay for it. Why is this just and necessary legislation?

1. By the time the building project is begun substantial amounts, 9 to 13% have been taken out of the original amount to take care of things such as financing charges, advance paid interest, credit report fees, title and escrow fees, title insurance fees, fire or other insurance premiums, etc. Theoretically, there should be enough left for the total cost of construction.

2. The lender should not take out of one fund to pay another project, such as deducting from the amount planned for plumbing and putting it on the carpenters project.

Subordination arrangements tend to accelerate the construction in an area and cause the granting of additional loans. The bill is trying to see that monies are held and that there is no 125% financing of projects.

The act contains four things: definitions, acts to be performed, stated exceptions, and remedies which are provided for violations of the bill.

Construction control should have at the lending institution complete plans under which the building will go forth. This is first requirement.

Second is the requirement that the lender and construction control obtain net figures of monies that will be available for the construction after deduction all the usual items.

Third requires construction control of the general contractor or of the owner-contractor if the construction is to be made by a person who is both owner and contractor. Subcontractors bids must be on file.

Fourth requirement is a comparison of the instrumentation with the net proceeds to see if net proceeds are enough to build the building.

Fifth provision is that categories of disbursements be made. There should be set aside a certain amount for plumbing, so much for carpentering, etc. This is being done now.

Six requirement is that there is a determination as to whether there is any retained surplus. If there is, the next step is to get an authorization from the borrower so that this money may be used to build up any of these categories that might run short.

The heart of the bill is paragraph 12, section 25 which provides that if existing monies are not brought about by subordination all that is required to be retained is 10% of the amount of the building costs. This must be supplied by the borrower. No disbursements of funds unless amounts needed for building are there. This must be proved by documented proof by lender and construction control--that net proceeds of the loan are enough to cover the construction.

If there is a failure to comply with the provisions of the bill then there are remedies--right of recovery against lender and construction control. Such legislation is necessary to prevent bankruptcies and foreclosures. The bill merely presents good lending practices.

Mr. Kean: Supposing a subcontractor is not paid for his material and he files a lien on the property?

Mr. Miles: The bill requires that when payments are made lien releases are obtained. How can you solve this situation of other potential suppliers? I don't know the answer to that. I don't think you can provide that any supplier will supply the names of all the other suppliers.

Senator Monroe: Are there instances in speculative building where projects are undertaken and the full amount of money that is required is not available at the start and they are expecting that homes will be sold and monies come in as they go along?

Mr. Miles: This situation does exist. Many times these builders can borrow money with a land draw only.

Senator Monroe: Would this bill tend to restrict these people on these projects?

Mr. Miles: Probably so but this will be good.

Mr. Lahr: Where did Mr. Miles go and who offered him this money with no plans or specifications?

Mr. Miles: You indicated yourself last week that such loans could be obtained and then additional loans obtained as the thing went along and you felt that this was good business practice.

Mr. Lahr: There has been a misunderstanding.

Mr. Lahr then went on to outline a transaction that his firm had had that involved \$850,000 which he felt fit in this business of getting additional loans as the

thing went along.

Mr. Miles: The surplus should be held to pay the bills. As of now, these speculators can take this money and walk away with it.

Mr. Lahr: I have never seen this happen. As to charges up to 13% plus the interest factor. As far as charges of interest in advance these are monies set aside and taken out monthly as it falls due. If the building involved is completed in four months the interest is available and he gets it back. In regard to the minimum factor to insure title for 29 years. State law prohibits more than 12% in any one year. 6% on the loan fee goes over the 29 years and comes out  $6\frac{1}{4}\%$ .

Mr. Miles: I did not intend to intimate that these loans were exorbitant. Just wanted to call attention that they were there and must be deducted before the net proceeds of a loan could be determined.

Senator Monroe: Will this bill slow down construction in this state?

Mr. Miles: Yes, it may defeat the building program some.

William Francis, of Southern Nevada Savings and Loan industry, stated that he had been connected with construction control for 7 years and had been responsible for disbursement of hundreds of millions of dollars of construction funds and that he felt qualified to speak on this matter.

Mr. Francis: This legislation is restrictive and invades the lender's right to make his own best judgment. I feel that the present system is good and is working. This legislation would do our thinking and make our judgments for us. 6,000 savings and loan members reported that no other state has such legislation. It is not necessary. This matter can be handled within the framework of the industry. This bill would force us to eliminate this type of lending completely. We feel that we are at present handling this phase properly. We have met with various groups in construction and have offered to hold seminars regarding this part of their business and they are receptive to this.

Mr. Francis: In regard to Sec. 25, what constitutes a true copy of the contracts and of the subcontracts? What binds an individual to a statement made by him? Is there a penalty if there is a false contract? What protection is there for the lender if the lien release is a forgery? What if the contractor uses two supply houses and submits a release from only one?

Mr. Francis: Reference has been made to a change order which might cause the spending of the extra monies. There are instances when the owner does not have additional funds but the lender may like to take other securities and loan additional monies. Or the owner might be able to make other arrangements with the subcontractors which would allow the job to be completed.

Mr. Francis: Section 26. We feel that the borrower should be allowed to recapture some equity in the land. If there is sufficient money to build and the builder has equity in the land, the lender should be allowed to use his judgment about letting him use some of this money.

Mr. Francis: I take exception to Mr. Miles' statement that most loans

in Clark County made by land draws. A complete survey was made down there and it was found that less than  $\frac{1}{2}$  of 1% were cases that involved property where building was not completed and which would require additional funds to complete. None of these involved land draws.

Bill Wendell, Representative of Nevada Subcontractors: Are there set rules for lending these monies or do they make their rules as they go?

Mr. Francis: We do obtain plans and specifications.

Mr. Wendell: Do they obtain copies of the subcontracts?

Mr. Francis: Yes, we do.

Mr. Wendell: What happens if the contractor withdraws too much money and leaves the subcontractor short?

Mr. Francis: This is handled by complete cooperation of contractors and subcontractors.

Mr. Wendell: I have two personal experiences where I contracted to do work and was told that by the time they reached me, a subcontractor, the monies were all gone and there was none to pay me.

Mr. Francis: The subcontractors should contact the lender and see if there are sufficient funds to pay them.

Senator Dodge: If Mr. Francis speaks for the savings and loans, the criticisms do not seem to be too severe. Can we meet some of these objections? Can we answer the objections about whether or not it is a true copy of plans or specifications by saying "to the best of my knowledge"?

Mr. Francis: We might.

Senator Dodge: Mr. Francis said how would you tell if these were forged mechanic's lien releases or whether two or more were involved and only one in. What would you say, Mr. Francis, about Mr. Miles' comments about these releases?

Mr. Francis: Now a man still has lien rights if his employer forges his name to a lien release.

Senator Dodge: Do you have any solution?

Mr. Francis: We require releases to be notarized. We are putting men into the field to take care of this.

Senator Dodge: Supposing that there are change orders which require some additional monies. Nobody has foreseen this. Where do we get the money? Does nothing go forward with the work until the money is supplied?

David Goldwater, American Savings and Loan: This is the way it is being done now.

Senator Dodge: Then why is there any objection to this section?

Mr. Goldwater: We have no objection to this section. What they have done is to outline what is being done now.

Senator Dodge: You made the statement that in fact this bill placed you in a position of being a guarantor of payments or an insurer. Would you point out what section of the bill does this?

Mr. Goldwater: Section 28. This indicates that if a violation occurs in any of these provisions the lender is liable for all mechanic's liens. I think the Senator can understand that in the exigencies of the building business there are many things which can occur which will result in situations which would then render the first claim completely valueless, and which might require the lender to come forth with his own funds in case the owner was unable to do so. This creates a requirement that the lender before he makes a loan not only make sure that there are funds to build but also funds to take care of anything that might come up.

Senator Dodge: What if we were to say if there is any violation of any provision of the chapter that they could have recourse to the lender, and then do away with requirements 1 through 17.

Mr. Goldwater: That probably would just codify what we already do and get or give additional assurance.

Senator Dodge: Would you settle for that?

Mr. Goldwater: Certainly.

Senator Dodge: The land draw provision seems to be the bone of contention. If this really is a hooker then this is where we really should evaluate.

Mr. Goldwater: In order to survive in the savings and loan business and in order to obtain funds to make a loan we must make a first lien. We are not allowed to deal in second mortgages. The provision in this bill takes away our first position. The act restricts the lender. Under section 27 paragraph 5 further attempts are made to restrict the lender so he cannot make a loan if it is more than \$10,000 or 35% of the appraised value, whichever is the lesser. We are now permitted to make an 80% loan to the owner of a residential property and he may use it as he sees fit. This bill would interfere with authorization already given. Lots of loans are made to property owners without vouchers or plans. The loan is made only on the value of his property. In some cases, there is no protection for the subcontractors.

Mr. Knisley: Why does the man need to take part of his money before the deal is finished? Why can't he leave it there and take it all out at once?

Mr. Goldwater: This is a matter of business judgment. This would, in many instances, discourage both lender and borrower. There may be more than one person involved, such as an owner and a developer. There is more than one way to make a deal.

Mr. Goldwater: Mr. Miles suggested we face reality. This is what the bill does

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not do. It must be kept in mind that we have in the Free Enterprise System suggested that everybody takes some risks in some areas. This bill assumes that there is one segment of the population that does not take any risk at all. They should take the normal risks that anybody else takes. There are many protections for them now, such as mechanic's liens, suits, etc. There is already a construction control that is working. Savings and Loans are audited at least once a year. They must be able to show a healthy flow of monies in the right channels. This act could very well, if it remains in its present form, make us very reluctant to get into the construction land business to any serious degree.

Senator Dodge: How about a 5-payment plan such as some banks use?

Mr. Goldwater: This does not work very well and would subject the subcontractor to even greater risks.

Senator Dodge: How about protecting ourselves with a bond?

Mr. Goldwater: With bonding there is difficulty when the time comes to make a settlement. They are slow, desultory, not satisfactory at all--a real mess in plain ugly terms.

Senator Dodge: Mr. Miles mentioned bankruptcies in dollar volumes. He feels that a lot of these are a result of loose lending policies on the part of the lenders even though we have these so-called safeguards. If it is not the fault of the lending institutions, how do they explain this?

Mr. Goldwater: There was an area in Clark County in 1962 that had an opportunity for building apartments and multiple dwellings. New hotels were built. A lot of opportunists came in. I am quite sure that the lenders in the area all wanted to participate in that opportunity, as well as the builders themselves. At the same time the law of supply and demand took over and the situation became rather tense. There were more units than people to occupy them. People in apartments bought homes and moved out of the apartments. When this got to the point where loan payments could not be met there were foreclosures. Some builders did walk away from the jobs. This situation was not created by the savings and loans or by the banks. I don't know if any of these resulted from a subcontractor depending on a savings and loan for his subsistence. Historically the subcontractor makes his bid on the basis that the contractor approaches him on a certain deal: What can you do to supply these items and what will you charge? The subcontractor doesn't usually know at that stage that he will be paid on a voucher system. This bill would make the lender a sort of general contractor because they would be responsible for a lot more than they are now.

Senator: Are there any further questions or people who want to speak for or against the bill?

Mr. Miles: With references to Mr. Knisely's comments: I think sections pertaining to land draws should be written.

Mr. Miles: With reference to Senator Dodge's suggestions concerning Section 25, 1-17. This is workable. I feel this bill has sufficient value to warrant its passage even without the land draw part. If we cannot have the whole pie, let's at least get the section that pertains to some of these important protections.

Mr. Miles: With reference to Mr. Dodge's comments about acts to be performed by construction control with reference to "true knowledge," "best of knowledge", etc. this could be done. I see no problem in the lien release section as to forgery. That would not be ~~the~~ fault of the lender and no liability falls on him. Mr. Francis indicated they go to great lengths to obtain these notarized releases, so there should be no problem.

Mr. Miles: With reference to Mr. Goldwater's statement that loan portfolios are audited regularly and are severely criticized if things are not in order: This act provides sanctions if there are violations and failures according to these provisions. The act is supplementary to the Federal Act and is civil in nature of responsibility.

Mr. Goldwater: The Federal Act sees to it that there is a properly documented loan but does not protect subcontractors.

Mr. Miles: With reference to Mr. Goldwater's statement that the savings and loans would not be interested in this type of business if the Act is passed: The act is only supplementary to the Federal requirements. These companies are not going to be out of business. They will be here as long as the state is.

Mr. Kean: Assuming that in the previous bill we were to add a section calling for a "notice of lien, then we would not have to have such tight control.

Mr. Miles: The reason it should state "permissive" is there is an absolute abundance of difficulty in obtaining descriptions of property and the owner of the property. I recently had the problem of filing a mechanic's lien for two people against mechanic's lien property. After going to numerous places, I finally obtained 7 documents which proved 3 individuals held title for 3 other corporations. Then there was a partnership involved. Then I went through 3 other documents to trace the transfer of the titles to find the title upon which I could record the mechanic's lien. It is hard to accomplish this at all when things are falling apart. If we make it a condition upon the subcontractor that he goes out and does all this research it is imposing a terrible burden upon these legally untutored people and many of them will lose money to which they are entitled.

Senator Dodge: Have him serve it on the person who is on the building permit.

Mr. Miles: This would have to be included in the act--that the notice of lien is to be served on the person whose name is on the building permit.

Mr. Lahr: Where a financial company is lending money, it must be a first lien, so it is simple to contact them to get the right owner or title to the property.

Hearing adjourned 4:00 P.M.