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Unlocking an Ambiguity of Home Improvement Financing: Classification of Fixtures, Goods and Building Materials

Home improvement spending is predicted to reach $485 billion in 2023. When a consumer wants to improve upon their property, they often seek financing for the project.

A finance company extending credit for home improvements may elect to obtain a security interest in the items financed. Filing a lien can perfect that interest and establish priority over other lienholders. Where the financing is for a "fixture" upon the consumer's real estate, a Uniform Commercial Code (UCC) fixture filing is permissible.

However, the question of whether an item financed constitutes a fixture is a notoriously ambiguous, case-specific question and may vary by state. Since any authoritative determination of status will generally take place after a filing has been made, correct classification at the time of filing is crucial.

To help finance companies navigate this issue, this article discusses the three-prong test commonly used to determine if items financed are, in fact, fixtures and offers practical recommendations for perfecting security interests in fixtures.

The Three Factors Determining Whether an Item Becomes a "Fixture"

According to *U.C.C. § 9-102*, fixtures are "goods that have become so related to particular real property that an interest in them arises under real property law." For example, water heaters, although separate goods at the time of purchase, generally become fixtures after they are incorporated into the home. However, other items financed are not so clear-cut, and the determination of whether an item is a fixture involves both UCC and real estate law.

The three factors that determine an item's status are: (1) degree of annexation to the real estate, (2) adaptation to the real estate, and (3) the intention of the party who annexed the item to the real estate.

These factors are discussed in more detail below.

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Factor 1: The *degree of annexation* (constructive or real) of the item to the real estate.

The more closely annexed an item is to the underlying real estate, the more likely it is to be a fixture. Considerations in evaluating the degree of annexation include the method of attachment and how easy or difficult it would be to remove the item from its location without substantial damage to the item itself or the real estate.

Factor 2: The *adaptation* of the item to the real estate, considering the property's uses and purpose.

Where an item has been adapted to the underlying real estate or where the underlying real estate has been adapted to accommodate the item, it is more likely the item will be a fixture. Considerations include customization of the item to fit the intended location and the importance of the item to the function of the specific real estate.

Factor 3: The *intention of the party* who annexed the item to the real estate.

The intention of the party who annexed the item that the item should remain with the real estate permanently is the most important of the three factors. Courts will consider the relationship of the parties as well as any overt agreements between them, such as a financing agreement.

An Additional Category: Ordinary Building Materials

Even when an item appears to be a fixture under the three-prong test, if it is so incorporated into the underlying real estate that it loses its separate character, it may be ordinary building material instead. In this case, a fixture filing is not appropriate. There is no *per se* test for determining whether an improvement is comprised of ordinary building materials, and states vary drastically in their conclusions. As with the three-prong fixture test, the analysis is highly fact-specific. As a general rule, materials used to build homes (such as wood, brick, concrete, etc.) as well as items that take their ultimate shape only upon installation, are more likely to be ordinary building materials.

Recommendations

Determining whether financed items are goods, fixtures or ordinary building materials can be complex. The factors described above provide useful, but not conclusive, guidance regarding this classification. Finance companies and other extenders of credit for home improvement must evaluate the extent to which a financed item is annexed to the underlying real estate, whether the item has been adapted to fit the real estate and whether the objective facts suggest an intention to make the item a permanent part of the real estate. Further, if the item is integrally incorporated into the real estate and has lost its separate identity, it likely constitutes ordinary building materials.

In the event of uncertainty regarding an item's status, a filer may consider making a fixture filing. Presuming the filing is made in good faith, this approach is expressly authorized under the UCC as a "precautionary fixture filing."

For more information about fixture filings or other questions related to consumer finance security interests, please contact Emily Hagan or another member of Reinhart's Consumer Finance Group.