The Lien Index

2021 Q2

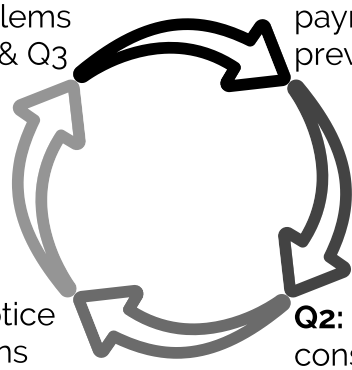
The Lien Index

Full Report

Understanding the Cyclical Nature of Mechanic's Lien Activity

In an average year, mechanic's lien filings are high in Q1, low in Q2 and Q3, and rise again in Q4. This is the cyclical, seasonal nature of the construction industry. Typically, Q2 and Q3 are active construction months; preliminary notice volume increases during these quarters, and payment issues frequently arise 60-120 days later, resulting in the lien filing increases in Q4 and Q1.

As an example, a construction project starts in April and various parties will furnish to the project in waves. A party may finish furnishing in September, then payment is delayed 60 days, resulting in the filing of a mechanic's lien in November.



Additionally, mechanic's lien activity is impacted by other factors, including catastrophic weather events, and general economic expansions and contractions. The number of liens filed may also increase proportionally when there is rapid growth in new construction starts.

The Vital Role of Mechanic's Lien Activity in Construction Credit

The filing of a mechanic's lien is a serious legal move and indicates cashflow issues, as the filing party has not received timely payment. The number one, and perhaps most obvious, question when a mechanic's lien is filed: Where is the money?

Cash flow issues can occur anywhere in the ladder of supply. It may start with the lender not releasing funds to the owner or the owner withholding funds from the GC. As we move further down the ladder of supply, funds move slower, drastically increasing DSO, with GCs failing to pay subcontractors and subcontractors not paying material suppliers.

Unfortunately, mechanic's lien filings are rarely presented as risks via credit reports, and they are therefore often neglected in the credit decision process. A review of mechanic's lien filings may uncover significant financial woes. If a company has been party to several mechanic's lien filings it should raise concern. If there is an influx of lien filings and your customer's name appears quite frequently, your customer could be experiencing cashflow issues.

Monitoring mechanic's lien activity is not all doom and gloom. In fact, as we are experiencing this quarter, a decrease in mechanic's lien activity is indicative of improved cashflow. Throughout the last 18+ months, construction companies have managed to preserve significant wells of cash, reducing the need to file mechanic's liens. However, as backlogs grow and if material prices and inventories don't ease, we are likely to start seeing increased lien activity towards the latter part of 2021.

The Q2 2021 Lien Index Score

The Lien Index reflected an increase in mechanic's lien activity in Q4 2020 and Q1 2021, as payment issues rose on construction projects. In Q2 2021, as expected, mechanic's lien activity dropped 9.6%. In line with typical trends, we anticipate Q3 2021 mechanic's lien activity will remain low, with an increase in activity expected in Q4 2021. Compared to the high mechanic's lien activity anomalies of Q2 and Q3 of 2020, mechanic's lien activity in 2021 has been on par with a typical construction cycle.

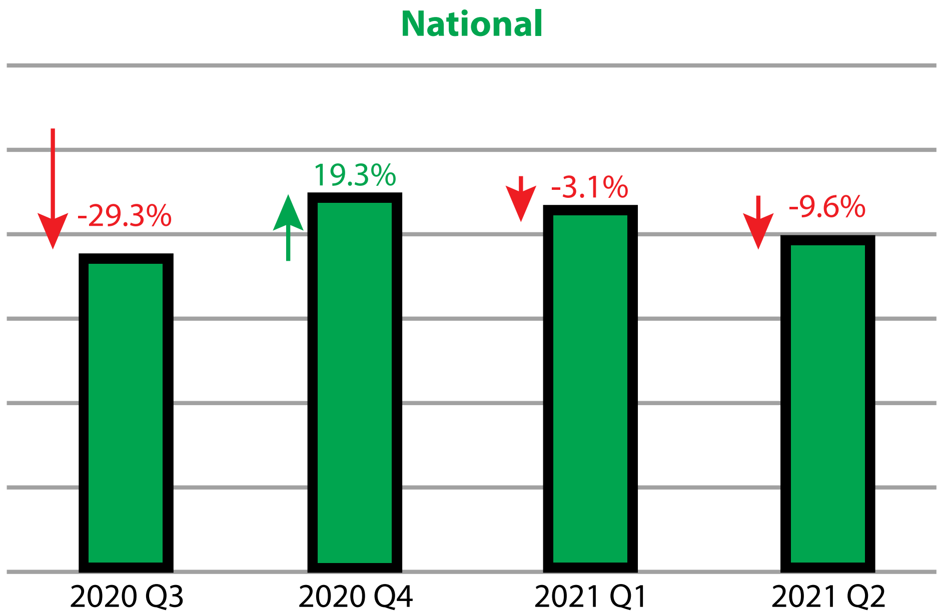
Two primary reasons for a decrease in lien activity:

1. Folks have cash/increase in working capital. They can pay their bills and are paying the bills timely.
2. Projects are in beginning stages; payments may not yet be due. As construction winds down in the fall/winter, we are likely to see a rise in payment issues.

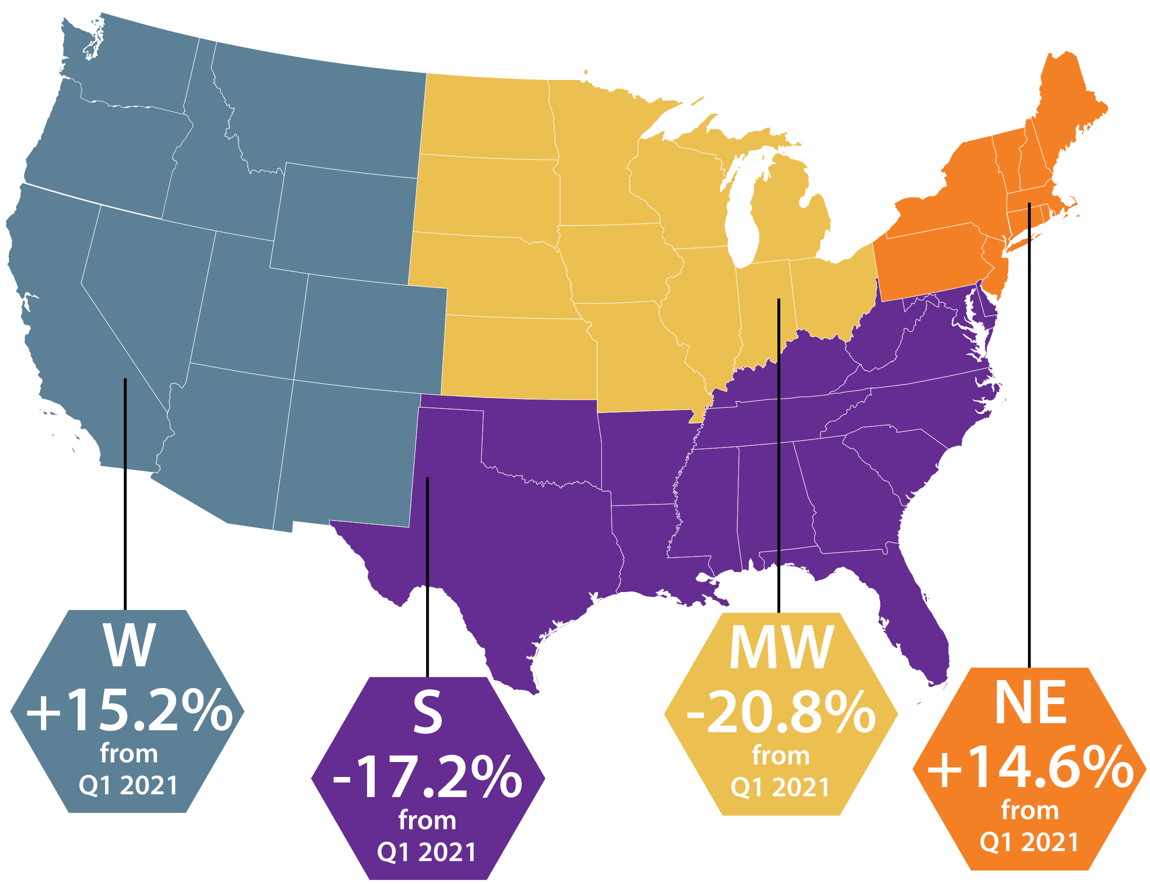
National Mechanic's Lien Data

The Lien Index jumped to 3.3% in Q2 2020, as the uncertainty and newness of the pandemic sent contractors, subcontractors, and material suppliers scrambling to secure mechanic's lien rights. As 2020 progressed and now into 2021, lien activity began to fall into a more normal cycle, with Q2 2021 lien activity dropping 9.6%. Based on current projections, lien activity should remain low into Q3 2021 and likely increase in Q4 2021.

In a review of the last four quarters, we see lien activity reacclimating to a more normal cycle (i.e., Q1 & Q4 high lien activity and Q2 & Q3 low lien activity). Q2 2020, at the onset of the pandemic and subsequent shutdowns, showed an extraordinarily high number of lien filings. As we moved from Q2 2020 to Q3 2020, lien activity began to decrease, slowly normalizing to a typical trend. Then, as expected, lien activity picked back up in Q4 2020 and Q1 2021 and has again decreased in Q2 2021.

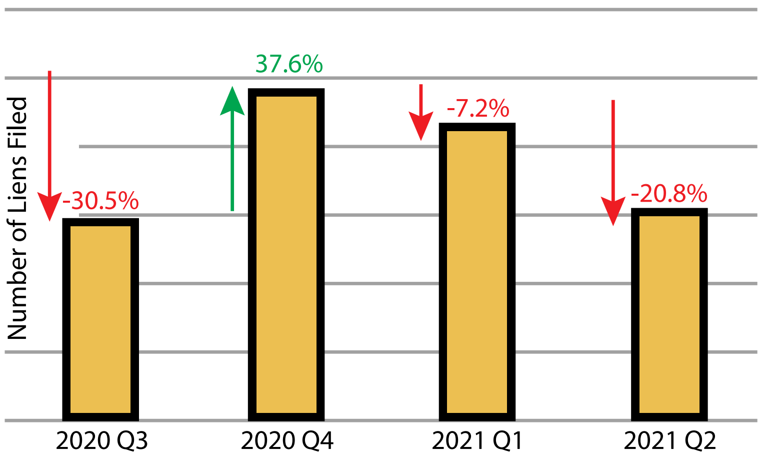


Regional Mechanic's Lien Data

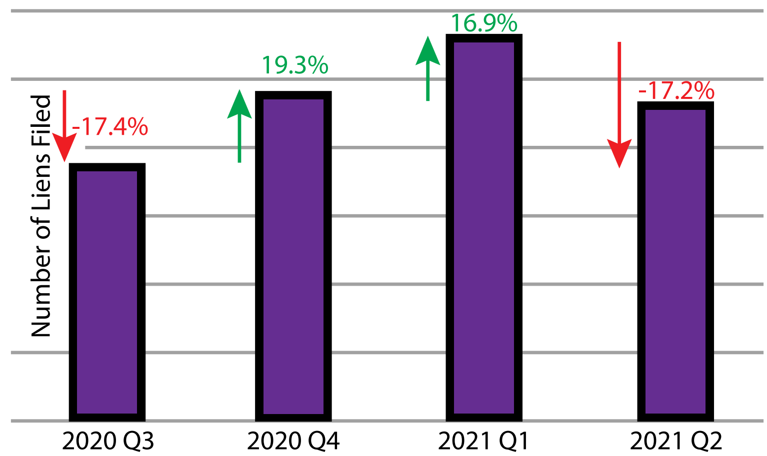


In line with expectations and the national trend, Q2 2021 lien activity in the Midwest and South regions dropped significantly over Q1 2021. Lien activity in the Midwest decreased 20.8% and the South decreased 17.2%.

Midwest

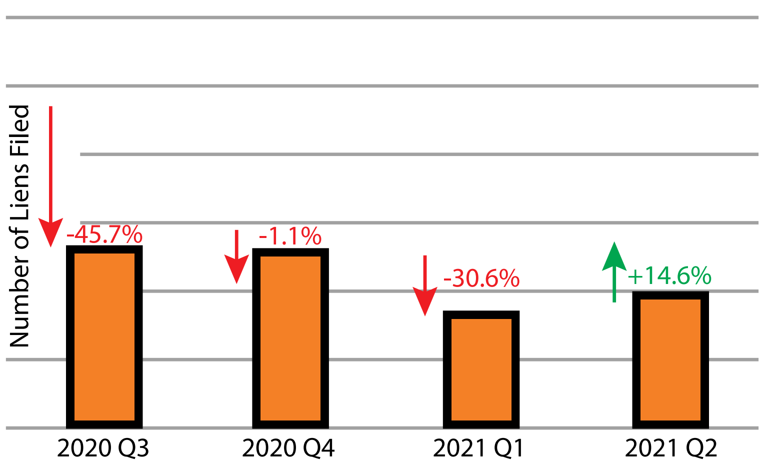


South

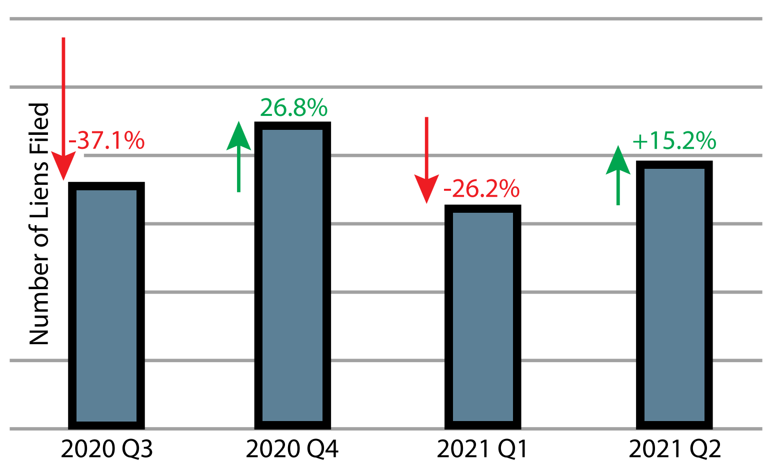


Interestingly, and against the national trend, Q2 2021 lien activity spiked in the Northeast and West regions, with the Northeast rising 14.6% and the West jumping 15.2%.

Northeast



West



Breaking down Q2 2021 national lien activity by region, we see the Northeast accounted for 11.1% of total liens, followed by the Midwest at 12.4%, the West at 19.2%, and the South had the highest volume of liens in Q2 2021 at 55.9%. Texas led the country in total lien filings for Q2 2021, followed by California, Florida, and New York.

A Look Ahead

The Q1 and early Q2 optimism of the vaccine and reopening of the economy has wearily waned with the emergence of the COVID Delta variant. A surge in infection rates will undoubtedly add pressure to employment rates and supply chains. And, however unlikely it may be, there is always a slight possibility of another shutdown.

Strong concerns remain in rising costs of materials and the wind down of financial assistance programs. Contractors will need to use their cash reserves and as the working capital depletes, contractors are likely to begin shifting funds between projects, which may lead to payment issues on projects, resulting in an increase of mechanic's lien activity. During this time of overall growth, it's imperative to carefully manage outstanding invoices, monitor the lien activity of your customers and your projects, and be in tune to the signs of financial distress.

Between the ABI's growth and the current backlog of projects, the construction industry maintains a cautiously hopeful outlook for the remainder of 2021 and into 2022. The Lien Index is tracking for another low activity quarter in Q3 2021. However, there are certainly factors that could thwart this positive track. Do not ignore this opportunity to implement security; secured transactions will prove to be a beneficial investment as we move into the latter half of 2021.

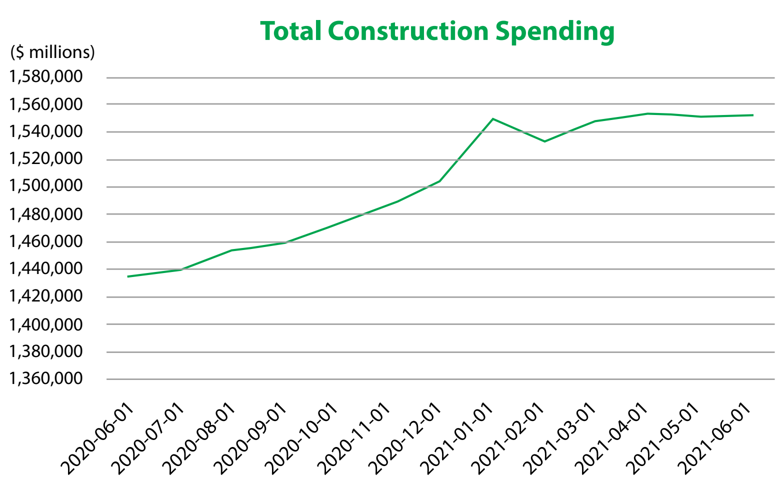
$ SPENDING

Lien Index Key Influences: Spending

"The U.S. economy expanded at a 6.5% annualized rate in the second quarter of 2021, pushing overall gross domestic product above pre-pandemic levels. Investment in nonresidential structures, however, declined 7% for the quarter and has now contracted in six of the past seven quarters..." – Associated Builders and Contractors

Total Construction Spending

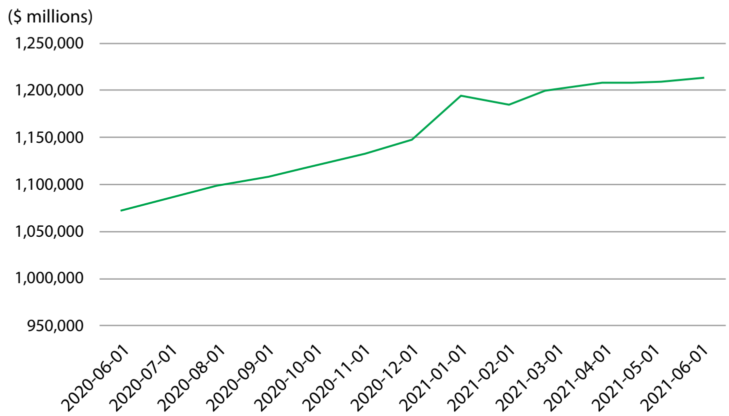
After recording a low in June 2020, total construction spending rapidly increased throughout 2020, hitting its peak in January 2021. We then saw a drop in spending mid-Q1 2021, and a rise coming into Q2 2021. Though spending did increase in Q2 2021, the increase has been fairly level with no significant change month over month. Federal Reserve Economic Data (FRED) reported total construction spending of $1,553,547M in April, $1,551,210M in May, and $1,552,200M in June.



Private Construction Spending

Private construction spending generally mirrored total construction spending throughout 2020 and into 2021, however, private construction spending hit its high in June 2021 at $1,215,214M.

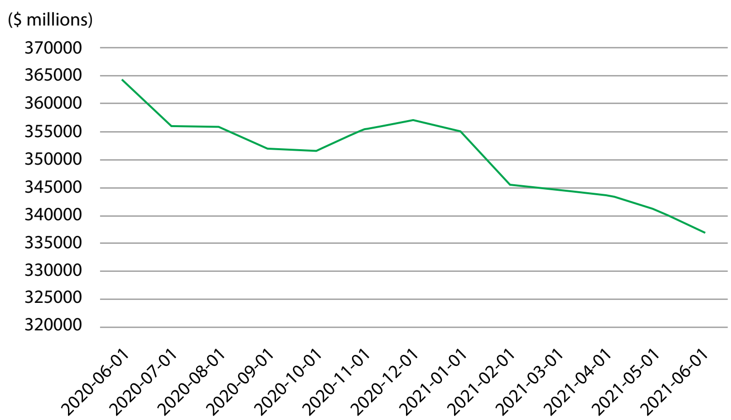
Total Construction Spending – Private Sector



Public Construction Spending

Unlike private construction spending, public construction spending has declined steadily over the 12 months, with $343,765M in April, $340,916M in May, and a low in June 2021 at $336,986M.

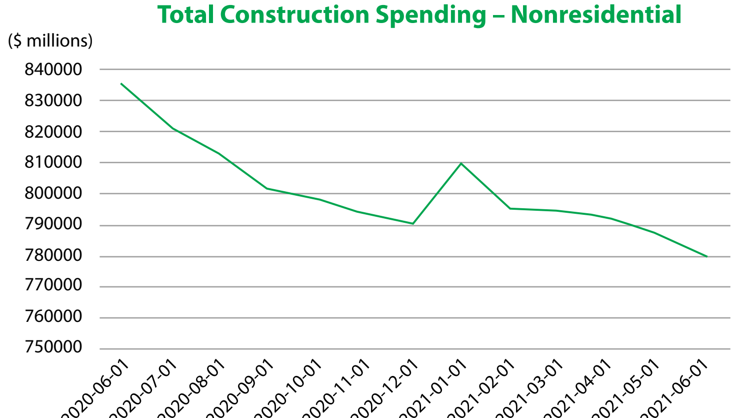
Total Construction Spending – Public Sector



Nonresidential Construction Spending

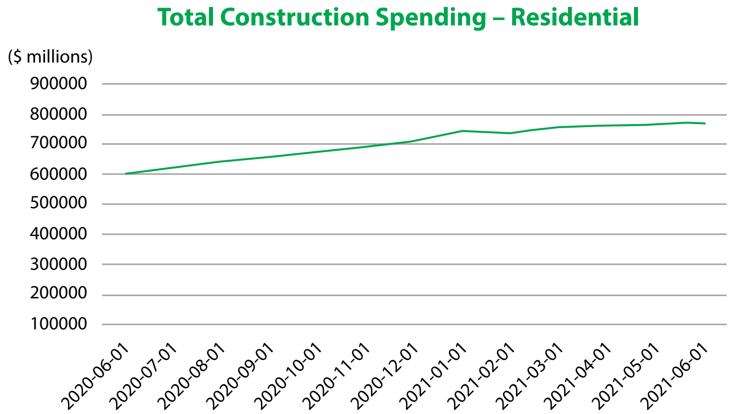
Nonresidential construction spending continues a 12 month decrease after a slight rise at the beginning of 2021, ending Q2 at its lowest in 12 months at $779,855M. Nonresidential construction spending is down 6.6% over a year ago, and down 12% since January 2020, according to a June 2021 report from Associated Builders and Contractors.

Total Construction Spending – Nonresidential



Residential Construction Spending

Residential construction spending continues to climb, though it has shown signs of slowed growth throughout Q2 2021. Despite the slowdown, residential construction spending posted $772,345M in June.



Bankruptcy Information

As we review overall spending, we'd be remiss to ignore bankruptcy data. Overall, bankruptcy filings have been low in 2021 and are predicted to remain low throughout 2021, due in large part to lending institutions continuing to offer low interest rates and forbearance. However, experts predict a surge in bankruptcies in 2022 as fiscal aid wanes.

> "Many financially distressed businesses and households have been able to weather the economic effects of the pandemic to this point through stabilization efforts by the federal government, lender forbearance and continued low interest rates," said ABI Executive Director Amy Quackenboss. "As consumers and companies navigate the post-pandemic economy amid receding relief programs, global supply challenges and potential inflation risks, bankruptcy provides a lifeline to families and businesses who may be struggling financially."

The American Bankruptcy Institute reported U.S. commercial bankruptcy filings were down 10% in April 2021 over April 2020 and down 31% in May 2021 over May 2020. June reported a 30% decrease in commercial bankruptcy filings for the first 6 months of 2021 vs. first 6 months of 2020. Despite the year over year decrease, June 2021 saw a 42% increase in filings over May 2021.

S&P Global Market Intelligence recently reported the majority of 2021 bankruptcies are in the consumer discretionary sector (e.g., retail, restaurants, travel, leisure activities), followed closely by the industrial sector. Rounding out the top five sectors at higher risk of bankruptcy are information technology, communication services, and utilities.

Again, as financial assistance stops and on-hand funds deplete, businesses will turn to creditors for extended payment terms, notoriously slow payers will pay even slower, and DSO will be pushed into uncomfortable ranges.

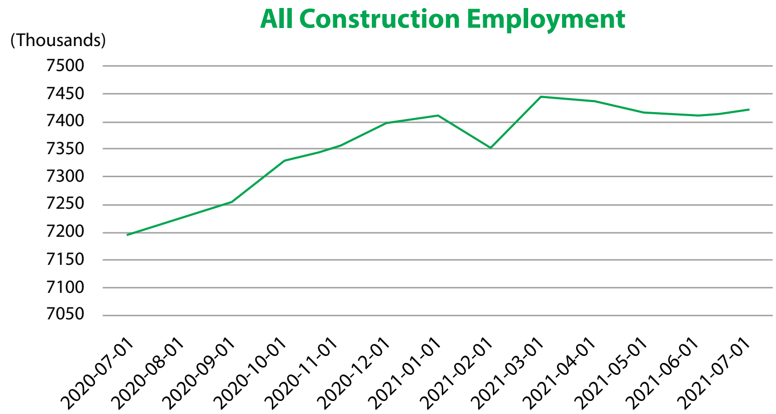
Speaking of DSO, in its Q2 2021 National Summary of Domestic Trade Receivables, The Credit Research Foundation reported DSO in Q2 was 37.71, which is down from 38 in Q1 and 41.56 a year ago. Also, accounts are reportedly 90.42% current, up from 84.62% a year ago.

WORKFORCE

Lien Index Key Influences: Workforce

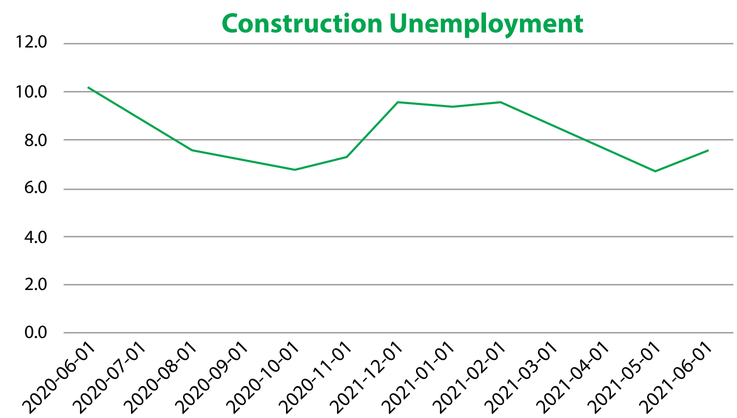
Total Construction Employment

Since Q2 2020, total construction employment has worked to recover, with its highest 12-month employee total at the end of Q1 2021. Throughout Q2 2021, total construction employment has remained up but relatively flat.



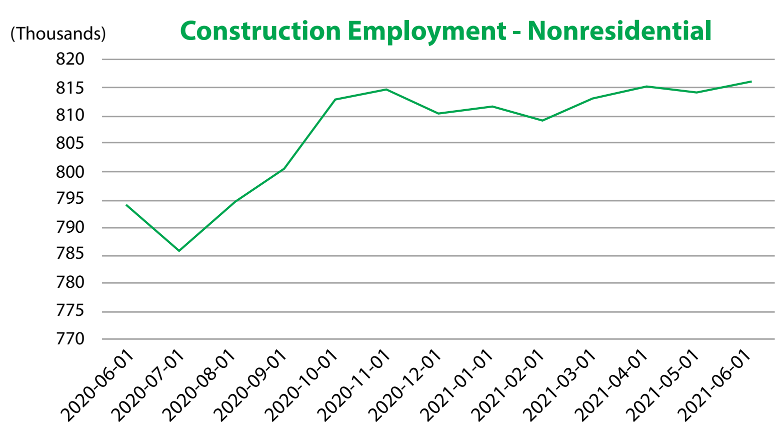
Total Construction Unemployment

Amid the height of the 2020 shutdowns, the construction unemployment rate was highest at 10.1 in June 2020. By May 2021, the construction unemployment rate had dropped to 6.7, and increased to 7.5 in June 2021.



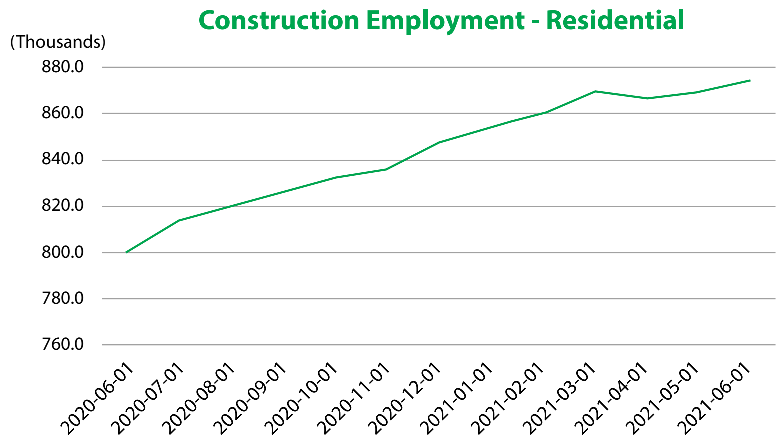
Nonresidential Construction Employment

Nonresidential construction employment has been more volatile than residential construction employment, with lows in Q4 2020 and Q1 2021. However, nonresidential construction employment has continued to rise over 12 months, ending Q2 2021 at 815.9 thousand.



Residential Construction Employment

Much like residential construction spending, the residential construction employment rate has grown over the last 12 months. At the end of Q2 2021, the residential workforce recorded a high of 874.2 thousand.



PROJECTS

Lien Index Key Influences: Projects

Architecture Billings Index

Since Q2 2020, total construction employment has worked to recover, with its highest 12-month employee total at the end of Q1 2021. Throughout Q2 2021, total construction employment has remained up but relatively flat.

In April, AIA's Architecture Billings Index (ABI) hit 57.9, the highest score since prior to the Great Recession. In addition to the rising score, ABI also reported "Interest in new projects remained extremely strong as well, with the Inquiries score rising to 70.8, and the value of new signed design contracts reaching 61.7, the highest score in that index since data collection started in late 2010. This means that not only are clients talking to architecture firms about starting new projects, but that they are also signing contracts to begin that work at a high rate."

In its April survey, ABI asked respondents about increasing material costs and over 1/3 of respondents indicated the increased cost in basic construction materials was a serious problem. Further, respondents were asked to rate the seriousness of current production and supply chain issues on a scale of 1 to 5, with 5 being most serious. Unsurprisingly, respondents rated these delays around 3.7 on the 5-point scale, and even higher in residential construction. Additional problems respondents faced included higher construction bids, project budget overruns, and general project delays.

May's ABI continued to climb hitting 58.5, its third consecutive month of growth. Notably, the value of new design contracts also hit an 11 year high. Concerns around inflation remained, with ABI citing the Producer Price Index increase: "The construction industry continues to see an even larger impact, with the PPI for materials and components for construction increasing by 3.9% in May alone, and by 17.0% from May 2020." Further, one respondent noted material shortages are increasingly becoming a concern: "Construction is still going at a breakneck pace. Material shortages are starting to have an impact on schedules—so far, projects haven't been cancelled because of price increases, but there is that danger."— 9-person firm in the West, residential specialization.

Rounding out Q2, the ABI maintained its record positive trek, coming in at 57.1 in June, noting it is near the highest levels in the history of the index. Further noting, "… inquiries surged to a new all-time high score of 71.8, and the value of new design contracts remained very high as well, with a score of 58.9. In addition, firms reported their highest backlogs in two years, with an average of 6.5 months. This ties the all-time high average since we started collecting backlog data on a quarterly basis in 2010, and follows a plummet down to just 5.0 months at the start of the COVID-19 pandemic." The continued increase is credited in part to a growth in transportation, travel/tourism, and manufacturing.

The Lien Index runs approximately 12-14 months behind the ABI. With the ABI continuing its rise, we anticipate an increase in lien activity, especially towards the end of 2022, beginning of 2023. At this pace, it's quite possible lien activity will remain high into Q2 2023, despite Q2 typically being a higher notice/lower lien period.

Associated Buildings and Contractors' Construction Backlog Indicator
In Q2, Associated Builders and Contractors' (ABC) Construction Backlog Indicator (CBI) steadily increased to 7.9 months in April, 8.0 months in May, and 8.5 months in June. Of the three months, June certainly showed the highest year over year change at 0.4 months. Though, this isn't overly surprising, as much of the industry was shut down and/or limited in June 2020.

While the CBI steadily increased, ABC's Construction Confidence Index (CCI) experienced some decline in Q2. In April, sales and profit margins reportedly declined, yet confidence in staffing increased. In May, sales increased slightly, but confidence in profit margins joined staffing confidences with a decline. Q2 ended with June showing growth increases in sales, profits, and staffing. Despite the modest ups and downs this quarter, ABC reports all three indices remain above the threshold of 50, which indicates expectations of growth.

> "Nonresidential contractors continue to predict a strong rebound in activity over the balance of the year," said ABC Chief Economist Anirban Basu. "Despite recent weakness in industry employment and spending data, contractors collectively remain upbeat. The neck-snapping pace of economic recovery, along with low financing costs and the return of projects that had been placed on the back burner during the pandemic, is translating into rising backlog and optimistic perspectives on employment, sales and profit margins."

These project backlogs indicate construction will be quite busy throughout 2021, which further supports the Lien Index predictions of high mechanic's lien activity in the latter part of 2022 and first half of 2023.

Dodge Data & Analytics
Dodge Data & Analytics (Dodge) reported the Dodge Momentum Index started Q2 strong but slowed in June. Dodge reported an 8.6% gain in April, noting the increase will likely not impact construction starts until late 2021/early 2022. May came in with a 9.1% increase, credited in large part to an increase in commercial planning.

> "Commercial planning had been in a holding pattern over the last four months, but broke out in May due to several sizable data center, office, and warehouse projects that peaked in a 13-year high for the commercial component of the Momentum Index."

Unfortunately, after 6 months of gains, June fell 5% from May. Dodge cites uncertainty in demand for buildings such as hotels and retail establishments. Dodge further indicates all signals point to "...a more broad-based recovery in nonresidential construction starts will occur in 2022."

In its review of the first half of 2021, Dodge reported the value of commercial and multifamily starts in the top 20 metro areas of the U.S. gained 12%. Leading the way was the New York metro area, followed by Dallas (TX), and Washington DC. Rounding out Dodge's top 10: Boston (MA), Miami (FL), Los Angeles (CA), Philadelphia (PA), Seattle (WA), Atlanta (GA), and Austin (TX). Dodge reported these top 10 areas accounted for 40% of all commercial and multifamily starts in the U.S. in the first half of 2021 and the first half of 2020.

According to the Lien Index, the states covering these top metro areas accounted for 54.3% of national mechanic's lien activity in Q4 2020, 60.7% of national mechanic's lien activity in Q1 2021, and 58.5% of national lien activity in Q2 2021, despite a decrease in overall Q2 lien activity. Based on their large market share, you should expect high lien activity to continue in these areas as we move through 2021 and into 2022.

U.S. Bureau of Labor Statistics Consumer Price Index and Producer Price Index
Inflation is the word. The U.S. Bureau of Labor Statistics Consumer Price Index (CPI) experienced its largest 12-month increase since the fall of 2008, with April increasing 0.8%, May increasing 0.6%, and June increasing 0.9%.

The Producer Price Index (PPI) also experienced its largest 12-month increase, with April increasing 0.6%, May increasing 0.8%, and June increasing a full 1.0%.

> "Construction input prices are 24.8% higher than a year ago, while nonresidential construction input prices are up 24.6% over that span. As has been the trend for several months, all three energy subcategories experienced significant year-over-year price increases. The price of crude petroleum has risen 108.8%, while natural gas and unprocessed energy materials prices have increased 105.9% and 83.5%, respectively. Though prices for softwood lumber are up 125.3% over the past year, they were down 2.1% on a monthly basis." – Associated Builders and Contractors analysis of Producer Price Index Data

Inflation remains a primary concern for the construction industry. Lumber prices have come down, but steel prices continue to increase. As the PPI remains high or increases, the financial risk to construction remains. Project owners will expect General Contractors and others in the ladder of supply to carry the burden of increased costs. If contractors and suppliers fail to effectively manage their profit margins and mitigate the risk, cashflow will tighten and the Lien Index will increase.

Equipment Leasing and Finance Association's Monthly Leasing and Finance Index
Equipment Leasing and Finance Association's (ELFA) Monthly Leasing and Finance Index (MLFI-25) in April showed new business volume up 19% over April 2020 and 5% up over March.

> "Respondents showed robust April business activity, attesting to a strengthening economy… The economy and business activity still have a ways to go to return to pre-pandemic levels, but what we see so far in terms of capital equipment investment is indeed encouraging as we head into the summer months." - ELFA President and CEO Ralph Petta

May 2021 was 20% up over May 2020 but down 17% over April 2021 and June growth jumped 17% year over year and 28% over May. Year to date, new business volume was up approximately 9% compared to 2020.

> "If equipment finance new business volume at the end of Q2 is any indication, the second half of the year should be as strong as economists predict. Despite slower-than-desired vaccinations in certain parts of the U.S, consumer spending is accelerating, markets remain strong and unem ployment continues to slowly abate, all of which are contributing to a strong economy. This por tends well for the equipment finance sector as we move into the second half of 2021. Recent pronouncements from the Fed indicate that they are eyeing recent upticks in inflation warily, but interest rates should remain low—at least in the near- to medium-term." - ELFA President and CEO Ralph Petta

ELFA further announced the Equipment Leasing & Finance Foundation's Monthly Confidence Index (MCI-EFI) was at an all-time high in April of 76.1, dropping a bit to 72.1 in May and inching up to 71.3 in June.

Institute for Supply Management's Manufacturing PMI
Institute for Supply Management's (ISM) Manufacturing PMI ended Q2 at 60.6% in June, down from 61.2% in May, but up from April's 60.7%. The Manufacturing PMI registers readings over 50% as expansion of the overall economy, and at the end of Q2, readings were over 50% for the 13th consecutive month.

"The Manufacturing PMI® continued to indicate strong sector expansion and U.S. economic growth in June. Four out of five subindexes that directly factor into the Manufacturing PMI® were in growth territory. All of the six biggest manufacturing industries expanded, in the following order: Computer & Electronic Products; Chemical Products; Fabricated Metal Products; Transportation Equipment; Food, Beverage & Tobacco Products; and Petroleum & Coal Products. The New Orders and Production indexes continued to expand at strong levels. The Supplier Deliveries Index continued to reflect suppliers' difficulties in maintaining delivery rates, due to a lack of direct labor, transportation challenges and increased demand. Nine out of 10 subindexes were positive for the period; a reading of 'too low' for Customers' Inventories Index is considered a positive for future production."

ISM also reports the following commodities continue to be in short supply: aluminum, aluminum products, corrugate, electrical & electronic components, epoxy, fasteners, foam products, packaging supplies, plastic products, polyvinyl chloride (PVC) resin, printed circuit boards and components, semiconductors, and steel/steel products.

ISM's Production Index ended Q2 at 60.8% with its top 6 industries (petroleum & coal products, chemical products, computer & electronic products, fabricated metal products, transportation equipment, and food, beverage & tobacco products) continuing growth expansion. Though unsurprisingly, inventories remain low and unstable due to supplier limitations. Further, the ISM Prices Index ended Q2 at the highest the index has seen since July 1979, at 92.1%: "Virtually all basic and intermediate manufacturing materials are experiencing price increases as a result of product scarcity and the dynamics of supply and demand, with an increasing number of panelists reporting higher prices compared to May."

Government: Infrastructure Bill
H.R. 3684 – Infrastructure Investment and Jobs Act was introduced in June 2021. (As of this writing, it passed the Senate on 8/10/2021 and has moved to the House.) This bill would provide $550B in new infrastructure spending. The bill includes approximately $110B for roads and bridges, $73B for electric grid/power infrastructure, $66B for passenger and freight rail, $65B for broadband investments, $55B for water systems infrastructure, $39B for public transit, $25B for airports, $21B for environmental remediation, and $17B for ports and water ways.

The passage of this bill would certainly improve prospects in public construction. Heavy commercial construction contractors, heavy equipment rentals, and electrical material suppliers are just a few in the construction industry that can expect to see an increase in bid/project opportunities.

Though payment issues in public construction normally won't result in mechanic's lien activity (claims are made against payment bonds), it is possible the Lien Index will see an uptick, as some of this infrastructure spending is likely to occur under Public Private Partnerships and even leasehold situations. Large scale projects, as we would expect to see from infrastructure investment of this size, frequently cover multiple parcels across multiple states. Those furnishing to these projects should obtain as much information as possible on the parties involved in the projects, the location(s) of the projects, where materials are incorporated, and should begin securing payment rights as soon as possible.

To learn more:
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Statistics reflect information available at the time of Lien Index release date.