Securing Your Tomorrow®

The Lien Index

2021 Q3

The Lien Index

Executive Summary

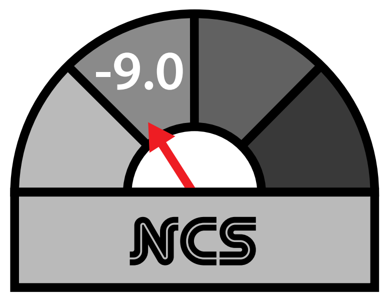
For over 50 years, NCS has been the foremost authority in secured transactions. As the premier mechanic's lien filer in North America, we provide services throughout the U.S. and Canada and across a myriad of construction industry verticals. Our extensive footprint, paired with decades of experience, affords us a unique perspective on economic trends in construction credit.

NCS' Lien Index is derived from carefully monitored national and regional mechanic's lien activity, construction economic data from various sources, and general economic trends. We've compiled and analyzed this data, to present to you in an easy-to-understand format. Our report includes NCS' Lien Index, key economic indicators, and trends, as well as our assessment on impacts to future construction business.

NCS' Lien Index compares mechanic's lien data, quarter over quarter. The standard is zero ("0"), with a number greater than 0 representing an increase in mechanic's lien activity, and less than 0 representing a decrease in mechanic's lien activity.

The Q3 Lien Index Score

The Lien Index increased slightly to -9.03% in Q3, up approximately .5% over Q2. Throughout Q3, national mechanic's lien activity remained relatively flat, though there were some significant changes regionally. We anticipate an increase in mechanic's lien activity in Q4. Although a Q4 increase would be in line with seasonal trends, the industry will continue to contend with the strain on the costs and availability of materials and labor.



Lien Index Key Influences

Projects

- Project backlogs remain positive, however have dropped throughout Q3 from 8.5 to 7.6 months, as contractor confidence declines.
- Architecture Billings Index dipped from its all-time high, but remains strong.
- Nonresidential contractors expect strong activity over the next 6 months.

Spending

- After several months on the rise, total construction spending ended Q3 down. Though, year over year, spending is up nearly 8%.
- As material prices continue to rise, Q3 saw an expected decline in private construction spending.
- Public construction spending rose throughout July and August but ended Q3 with a decline.

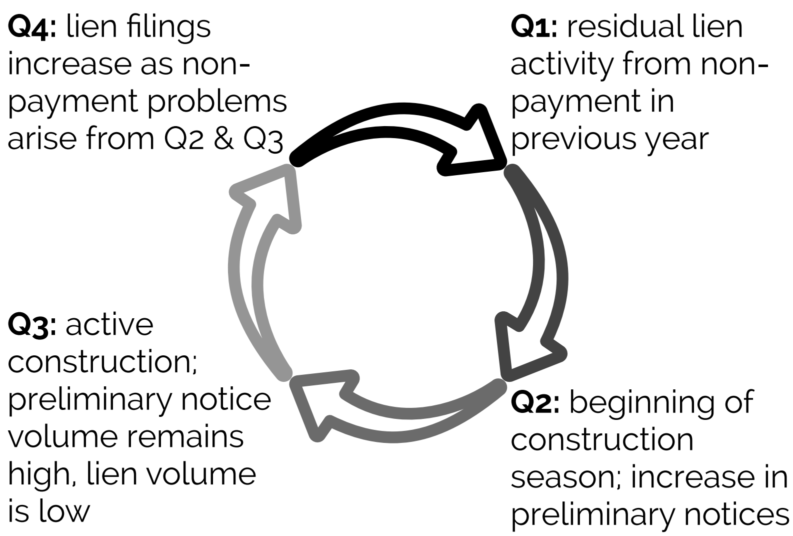
Workforce

- Total construction employment inched higher throughout Q3.
- Residential construction employment continued its 12-month steady-paced increase.
- Nonresidential construction employment dipped in the beginning of Q3, recovering in September.

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.

The Q3 2021 Lien Index Score

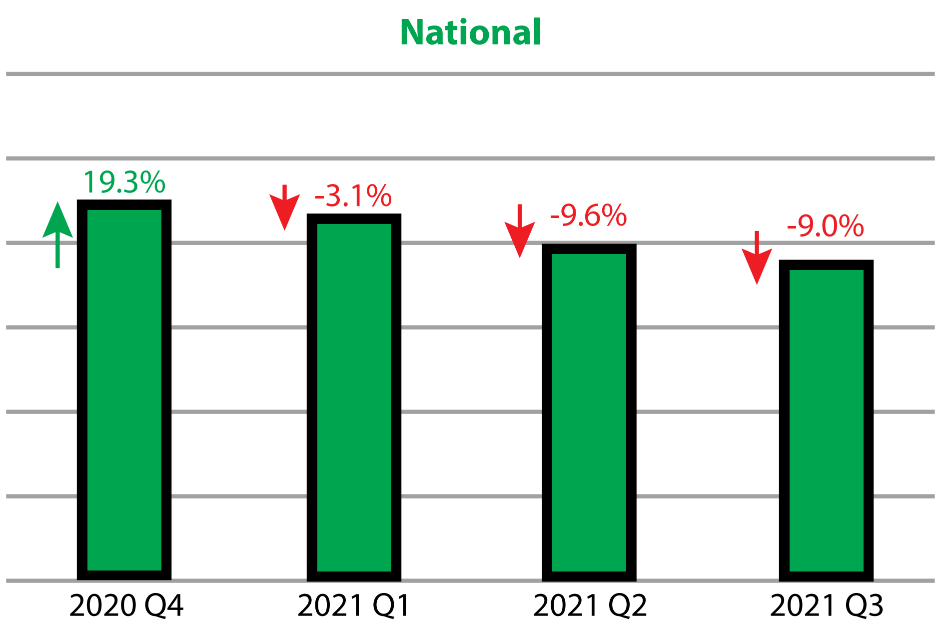
The Lien Index increased slightly to -9.03% in Q3, up approximately .5% over Q2. Throughout Q3, national mechanic's lien activity remained relatively flat, though there were some significant changes regionally.

The low lien activity in Q3 was due in part to businesses continuing to pull from and maintain strong working capital, and from projects in early stages. Typically, we would expect to see an increase in activity as we move through Q4 and into Q1 2022.

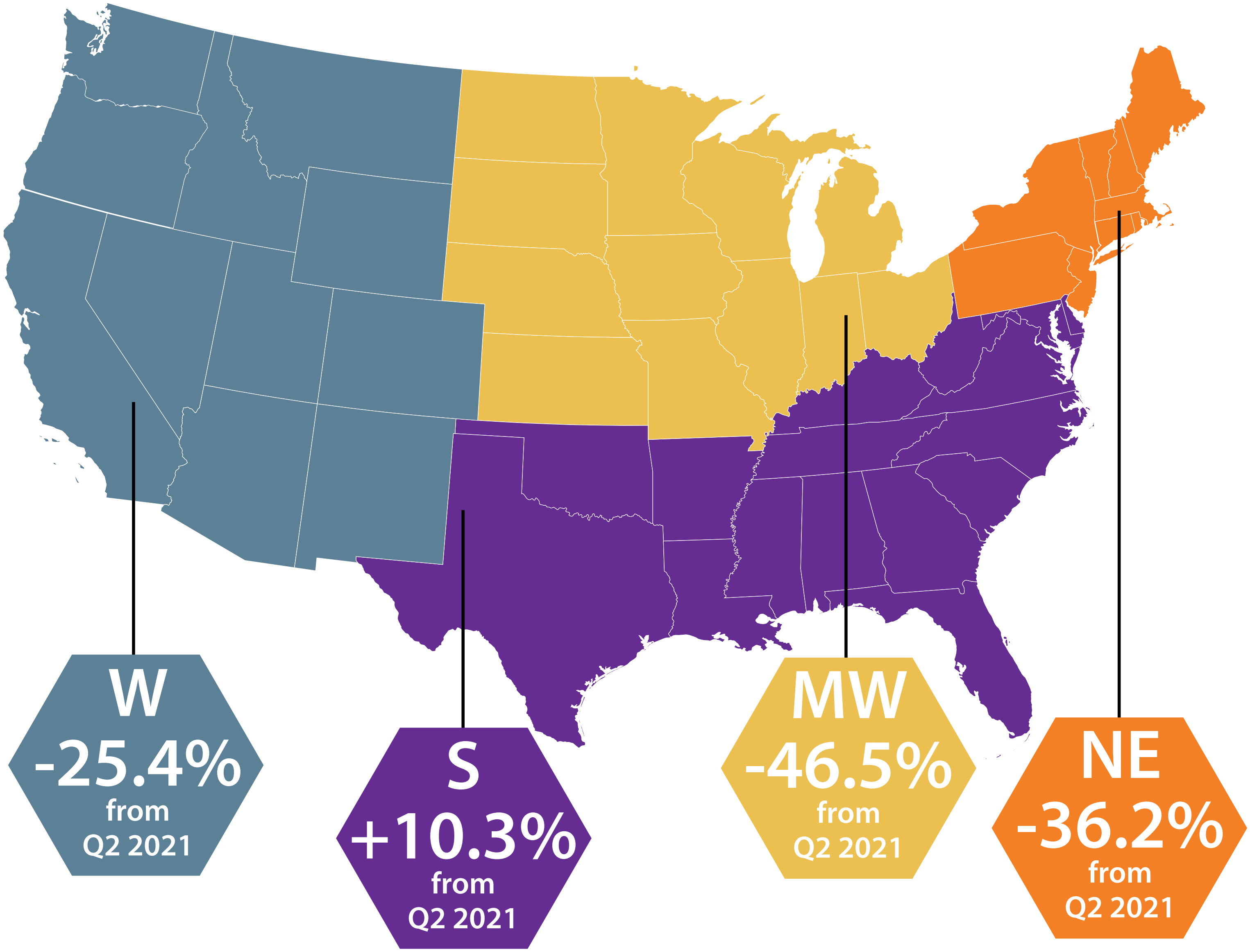
National Mechanic's Lien Data

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 Q3 lien activity rising a half percent to -9.03%. Based on current projections, lien activity should begin increasing toward the end of Q4 2021 and into Q1 2022.

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). Coming off high Q4 2020 activity, we started to see a decrease in activity in Q1 2021. The decrease continued through the first half of the year and has shown slight uptick in Q3, which is likely to continue in Q4.

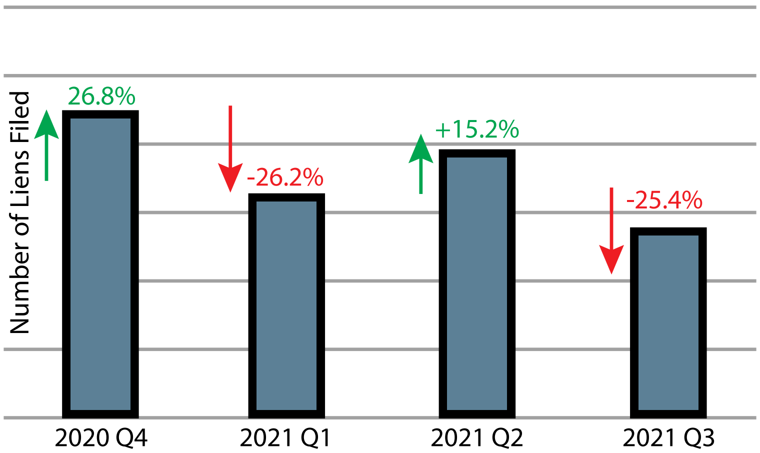


Regional Mechanic's Lien Data

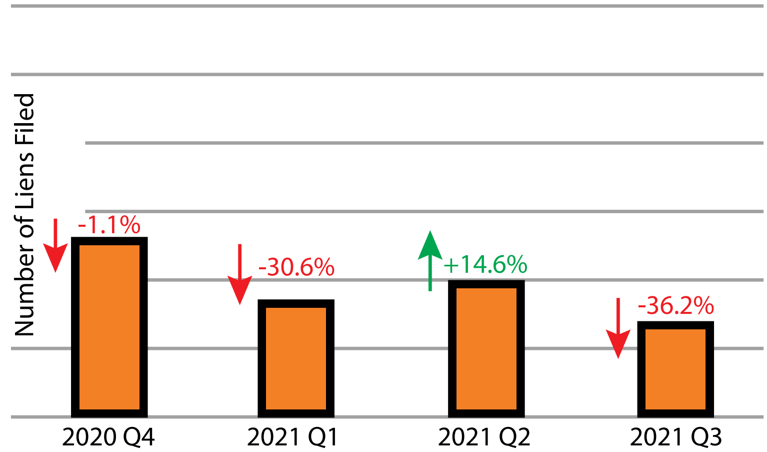


Lien activity was high in Q2 for the West and the Northeast, which made the Q3 declines seem more dramatic. The West ended Q3 at -25.44% and the Northeast at -36.24%. Despite the major declines, the low lien activity in Q3 was expected.

West

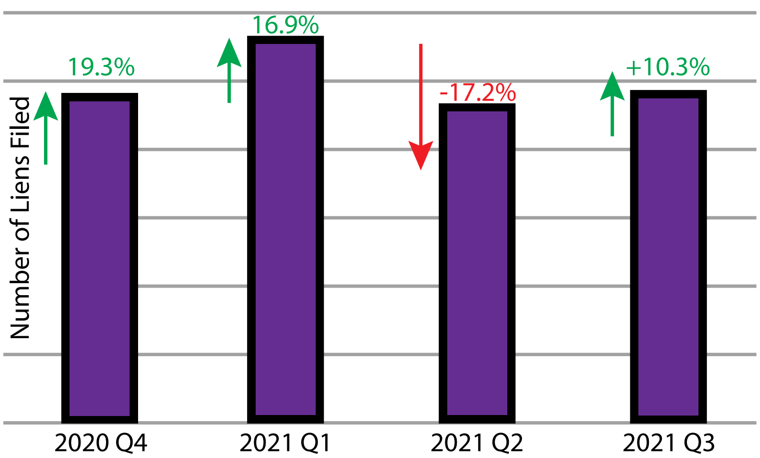


Northeast

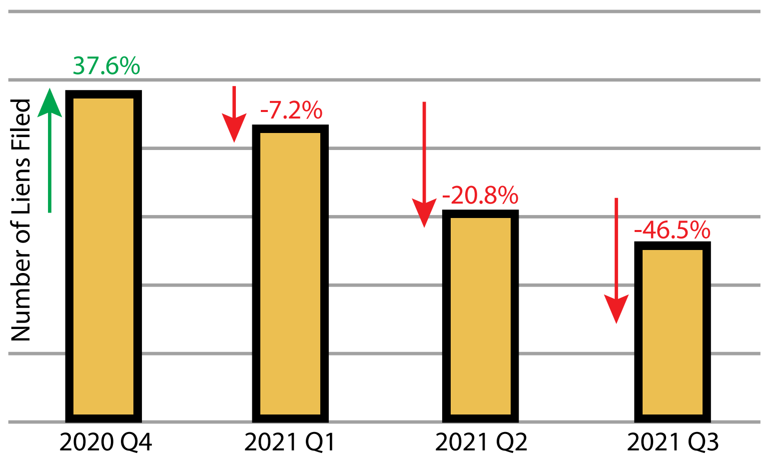


The South experienced a considerable spike in Q3 mechanic's lien activity coming in at +10.28%. Sources confirm material costs are at play, however, the significant weather and strong hurricane season have delayed and even halted projects, causing payment issues across the region.

South



Midwest



Midwest lien activity continued a four-quarter decline, ending Q3 at -46.48%. Based on trends, we would expect to see activity increase in Q4, but at its current pace, the Midwest may continue its low ride well into 2022.

Breaking down Q3 2021 national lien activity by region, unsurprisingly the South dominated with 68.45% of national lien activity. Lien activity in the other regions, all dwarfed by the South, included the West at 16.05%, the Northeast at 7.94%, and the Midwest at 7.56%. A virtual repeat of Q2, in Q3 Texas led the country in total lien filings, followed by California, Florida, and New York.

A Look Ahead

Yes, COVID remains a threat, however, it's not just the illness that's wreaking havoc. We continue to experience the longer-term economic side effects of COVID: material and labor shortages and price increases. We generally anticipate an increase in mechanic's lien activity in Q4, which is in line with seasonal trends. But, as the industry continues to contend with high costs and low availability of materials and labor, the Q4 increase may not be as significant as years prior. The construction industry has reported an increase in projects that were abandoned or failed to start in Q2/Q3 because the rising costs made construction impracticable or outright impossible. With fewer projects in play, businesses may retain cash reserves a bit longer, leading to a lower number of lien filings.

For projects that have managed to start and remain on track, be aware of funding shifting. To combat the rising costs, contractors will likely shift funds between projects, leading to payment issues. 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.

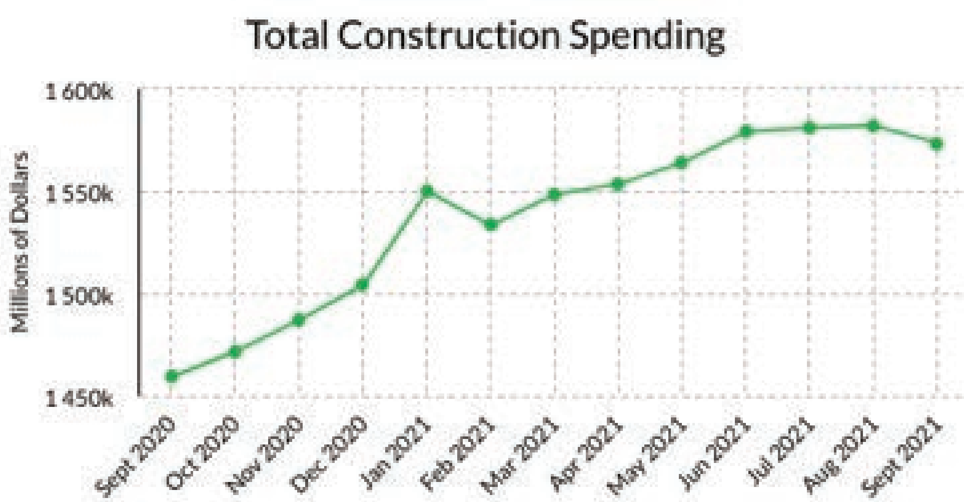
The industry remains cautiously optimistic, despite the drop in project backlog. The ABI experienced slight decreases, but growth trends continue. The Lien Index is tracking for an increase in lien activity in Q4, though perhaps not a substantial increase until Q1 2022. Do not ignore this opportunity to implement security; secured transactions will prove to be a beneficial investment as we move through 2021 into 2022.

$ SPENDING

Lien Index Key Influences: Spending

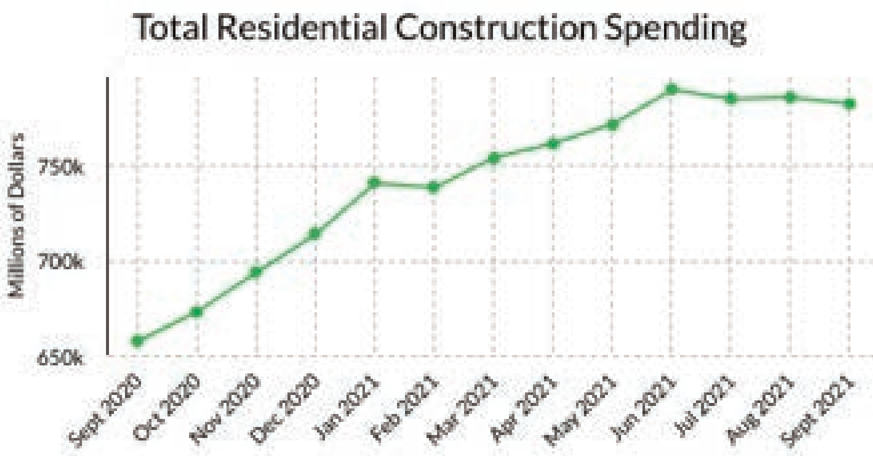
Total Construction Spending

According to data from Federal Reserve Bank of St. Louis (FRED), total construction spending in July was $1,581B up .03% over June. Spending increased slightly over July, with August coming in at $1,582B. Q3 ended with spending at $1,573.6B in September down .5% over August.



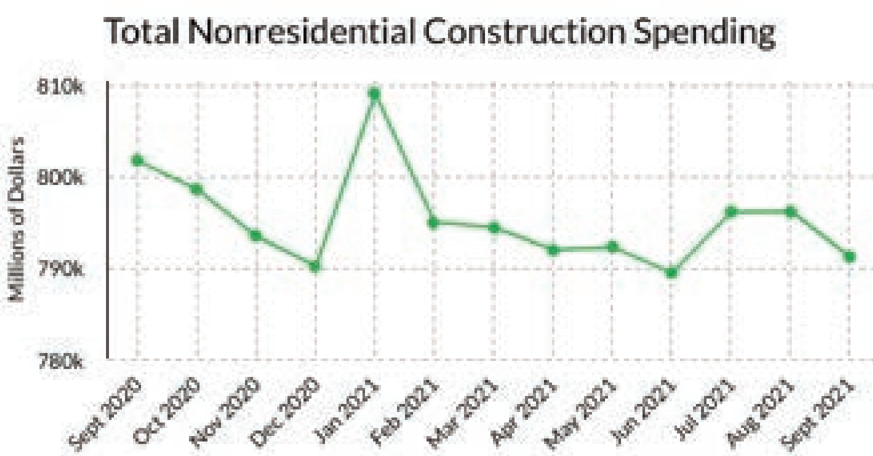
Residential Construction Spending

Residential construction spending lost some ground throughout Q3, with $785B in July, $785.9B in August, and $782.5B in September.



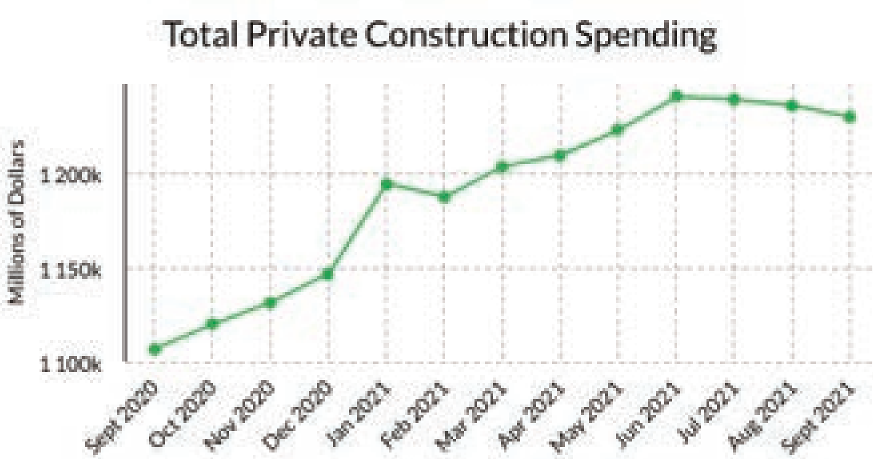
Nonresidential Construction Spending

Nonresidential private construction spending started Q3 with an increase over Q2 at $796.1B in July. Spending remained virtually unchanged with $796.2B in August and slid to $791.2B in September.



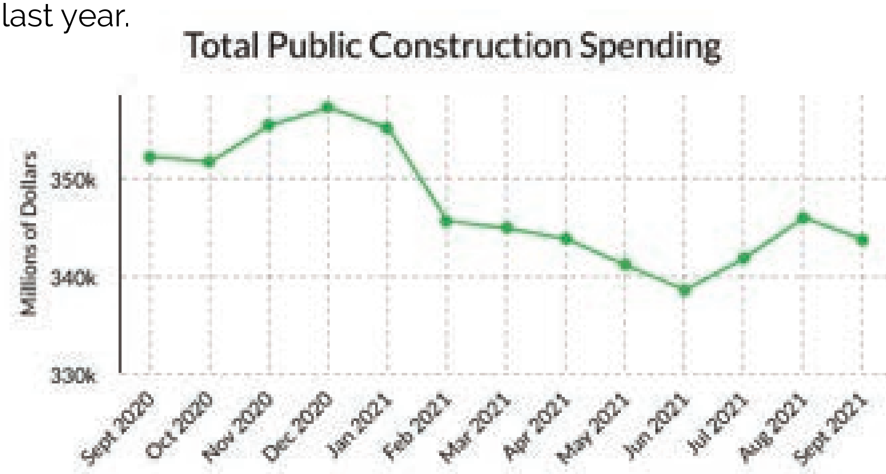
Private Construction Spending

Private construction spending came in at $1,239.3B in July and dropped to $1,236.1B in August. Q3 ended with spending at $1229.9B in September. Though spending has declined, Q3 recorded a higher spend that Q2.



Public Construction Spending

After a drop at the end of Q2, public construction spending increased to $341.8B in July, $345.9B in August, and then dipped to $343.7B in September. Despite the general gains, spending remains 2.4% below the same time last year.



"A growing number of contractors indicate that the combination of increasingly expensive labor and rising materials prices are inducing more project owners to postpone work. This has manifested itself in a number of ways, including the inability of nonresidential construction spending to achieve growth and a recent decline in backlog... As if this were not enough, a bipartisan infrastructure package that appeared set to pass is now jeopardized by jumbled political dynamics." – Associated Builders and Contractors

Bankruptcy Information

Bankruptcy filings continued to decline throughout Q3, with a 30% decrease in Chapter 11 filings from June to July and a 15% decrease in total commercial filings from June to July, according to Epiq AACER. Although filings remained low in August, Chapter 11 filings were up 8% in August compared to July, and overall, commercial filings increased 1% in August. Filings slid in September, with an overall decrease over August of 4%. Chapter 11 filings in September were down 6%. By the end of September, total bankruptcy cases were down 11% from the start of 2021.

> "The bankruptcy new filings volume and chapter mix trends will likely change over the coming months with the Federal and State programs like the eviction moratorium expiring on September 30, 2021," said Todd Madsen, senior director of Epiq Bankruptcy Analytics. "However, numerous states like California have rent reimbursement programs, with funds in place that will continue to ward off new bankruptcy filings as moratoriums expire."

In Q2 we touched on the wind down of government stabilization and bank forbearance programs and indicated businesses would be actively using cash reserves and requesting extended payment terms, increasing the likelihood of more bankruptcies at the end of 2021/beginning of 2022. This remains relevant, however, in the construction sector, if more construction projects are put on hold or abandoned due to rising material and labor costs, cash reserves may last businesses a bit longer. We may not see a rise in bankruptcies until well into 2022.

> ABI Executive Director Amy Quackenboss. "As relief programs recede, global supply chains are challenged and potential inflation looms, bankruptcy provides a proven lifeline for financially overwhelmed consumers and companies."

U.S. Bureau of Labor Statistics Producer Price Index and Consumer Price Index
U.S. Bureau of Labor Statistics Producer Price Index (PPI) rose 1% in July, .7% in August, and .5% in September. According to Associated Builders and Contractors' analysis of PPI data, construction input prices declined in September, but rose 18.9% over the same time last year. The Consumer Price Index (CPI) also spent Q3 on the rise, as it increased .5% in July, .3% in August, and .4% in September. The CPI has risen 5.4% over the last 12 months.

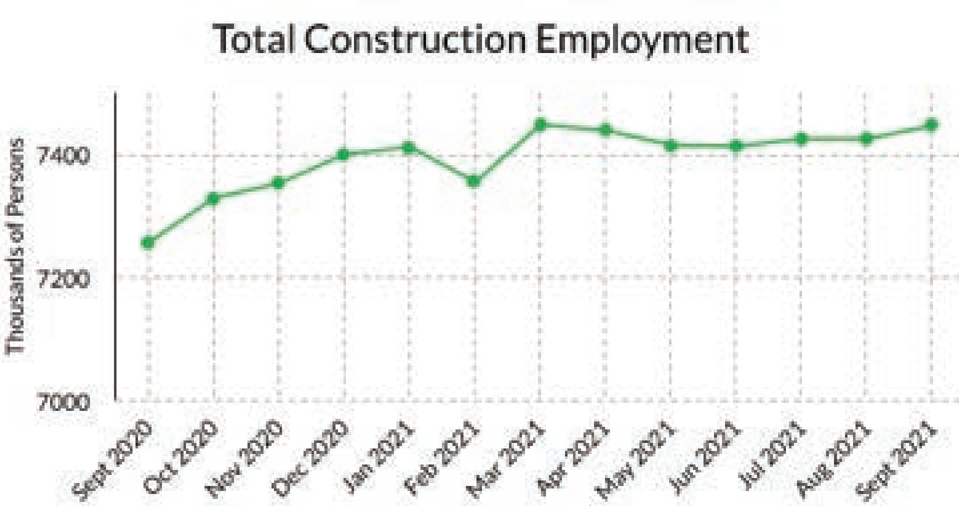
Much like Q2, inflation remains a primary concern for the construction industry. Lumber prices have come down, but steel prices continue to increase. As the PPI remains high, the financial risk to construction continues. Project owners will expect General Contractors and others in the ladder of supply 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.

According to U.S. Chamber of Commerce Commercial Construction Index – Q3 2021, 62% of contractors are concerned with the low availability of building products and 37% are concerned with an increase in worker shortages. Additional contractor concerns include worker health and safety, fewer projects, more project shutdowns and longer delays. An overwhelming 98% of contractors reported material cost fluctuations have a moderate to high impact on their business, including wood/lumber, steel, and copper.

WORKFORCE

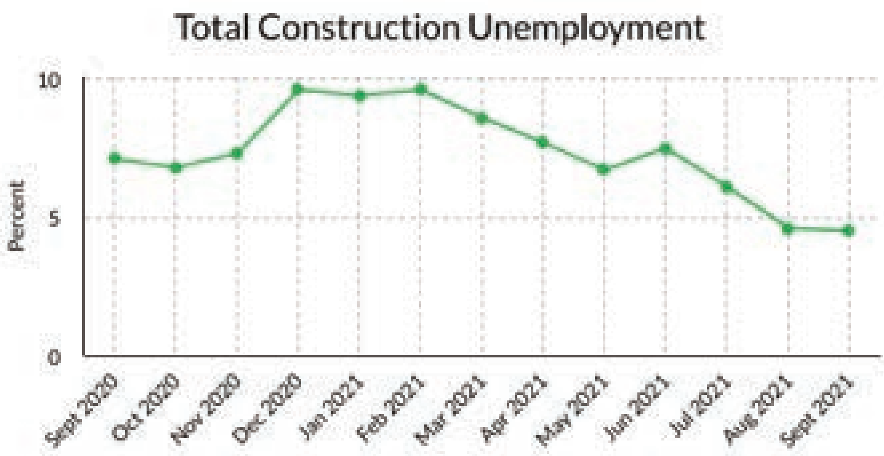
Lien Index Key Influences: Workforce

Total Construction Employment
Total construction employment remained relatively flat through Q3, with little change since May. July employment was 7,419, August employment was 7,416, and September employment came in at 7,447.



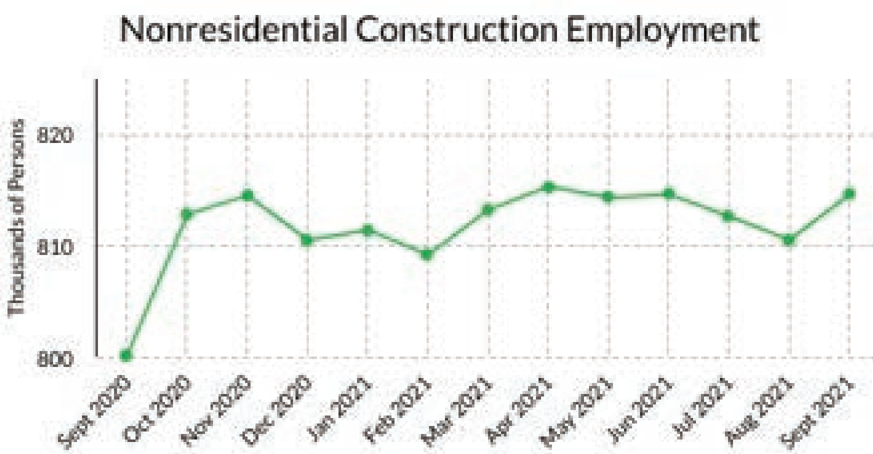
Total Construction Unemployment

Total construction unemployment steadily declined in Q3 after a jump in June. The unemployment rate was 6.1% in July, 4.6% in August, and 4.5% in September.



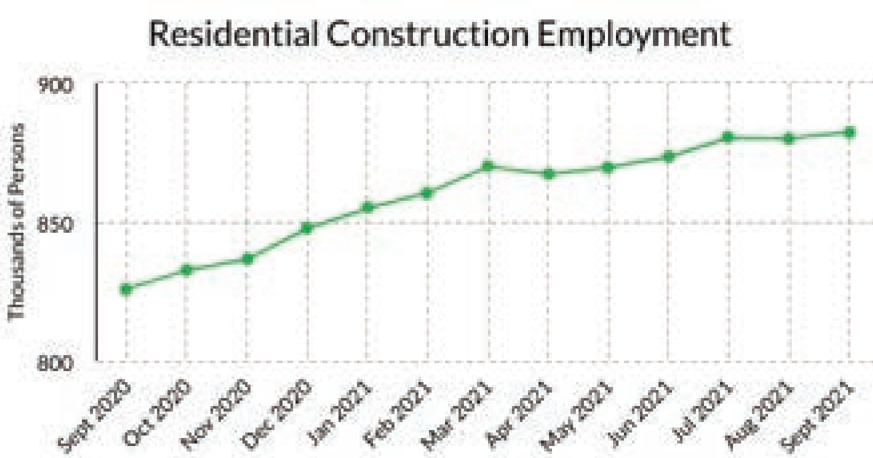
Nonresidential Construction Employment

After a gradual increase over Q1 and Q2, nonresidential construction employment started to decline in Q3. July dropped to 810.4, August dropped further to 807.6, then jumped to 814.6 in September.



Residential Construction Employment

Unlike its nonresidential counterpart, residential construction employment rose from Q2 to Q3, and showed little change throughout Q3. Q2 ended at 873.4, increased in July to 880.6, increased marginally in August to 880.7, and made its largest increase of Q3 in September, coming in at 882.3.



Lien Index Key Influences: Projects

Architecture Billings Index
AIA's Architecture Billings Index (ABI) declined in July to 54.6 from its peak in June (57.1). Despite the dip, the Index remained strong, reflecting firms continuing to see an increase in their billings. "Inquiries into new projects and the value of new design contracts remain extremely high as well, with both still near their all-time historic high points from earlier this year. The rate of growth that firms are reporting now is more typical for a post-recession recovery phase."

In ABI's July survey, respondents continued to cite concerns with construction material prices and availability, supply chain disruptions, worker shortages, and contractor availability for projects.

Continuing a strong path, the ABI rose to 55.6 in August, up a point over July. "Firms in all regions of the country continued to report growth in August as well, although the pace of growth has moderated somewhat at firms located in the Northeast over the last few months. Billings remained strongest at firms in the West and Midwest, while firms located in the South still reported increasing billings, but also expressed some concern about the impact of the ongoing—and already serious—hurricane season."

Rising another point in September, the ABI came in at 56.6. "The ABI scores over the last eight months continue to be among the highest ever seen in the immediate post-recession periods that have been captured throughout the index's history, underscoring just how strong the bounce back has been this year following the abrupt downturn in 2020. Firms continue to report plenty of work in the pipeline as well, with inquiries into new projects and the value of new design contracts remaining strong. In addition, backlogs at architecture firms reached a new high since we started collecting the data on a quarterly basis in late 2010, now averaging 6.6 months."

The Lien Index runs approximately 12-14 months behind the ABI. The strength of the ABI indicates we are likely to see an increase in lien activity, especially toward the end of 2022, beginning of 2023. It is possible lien activity will remain high into Q2 2023, despite Q2 typically being a lower lien period.

Associated Builders and Contractors' Construction Backlog Indicator
Associated Builders and Contractors' (ABC) Construction Backlog Indicator (CBI) remained unchanged in July from June at 8.5 months. ABC Chief Economist Anirban Basu stated the July survey results reflected a "dose of reality."

> "For several months, contractors have been signaling all systems go despite rising materials prices, expanding labor shortages and costs and the lingering pandemic. While contractors con tinue to believe that the next six months will see rising sales, staffing and margins, the level of confidence has become slightly less sanguine as backlog failed to expand in July." – Anirban Basu, ABC Chief Economist

Unfortunately, August dropped dramatically to 7.7 months. High material prices continue to contribute to project delays and, in some cases, rendering projects all but impossible. Though the lower confidence won't last long, according to Basu "With so much liquidity continuing to be injected into financial systems, investors have considerable sums to deploy in new investments. Real estate valuations and construction volumes benefit from such dynamics. Recent dips in commodity prices and more normal labor market functioning should help translate into slower cost escalations and rebounding backlog during the months ahead, ultimately reversing the backlog decline sustained in August."

The CBI lost a point in September as it fell to 7.6 months. Although the backlog has decreased, firms remain optimistic that growth will continue.

> "The good news is that demand for construction services remains elevated... Low interest rates and abundant liquidity have created the capacity for many investors to deploy substantial capital, and that helps support investment in real estate and construction projects. Despite all the chal lenges facing the nonresidential construction industry, contractors collectively expect sales, staffing and profit margins to expand over the next six months, though the level of confidence has been diminished in recent months." – Anirban Basu, ABC Chief Economist

Even though the backlog shrunk in Q3, the CBI generally remains positive. Contractors are expected to remain busy throughout 2021.

It's important to note, if labor shortages, material shortages, and price increases do not subside, the Lien Index will likely increase earlier in the second half of 2022 than originally forecasted. These shortages continue to strain productivity and adding significant project delays will increase mechanic's lien volume.

Dodge Data & Analytics

Dodge Data & Analytics (Dodge) reported the Dodge Momentum Index fell 6% in July from its June reading, with a 3% drop in commercial planning and 9% drop in institutional planning.

> "Construction material prices continue their march higher and are weighing heavily on construction starts... Lumber and copper prices have fallen in recent weeks; however, steel, plastic and other construction-related products are continuing their ascent. These increases will continue to impact construction starts over the coming months..." stated Richard Branch, Chief Economist for Dodge Data & Analytics, in Total Construction starts Move Lower in July.

The fall continued in August with a 3% decrease over July. August's commercial planning decreased 2% and institutional planning decreased 6%.

> "Despite the recent declines in the Momentum Index, it is still too early to call this a retrenchment or a new cyclical downturn. Demand for nonresidential buildings remains weak, but the recent rising number of new COVID cases should not cause the same amount of disruption as previous waves did. As the economy continues to trudge forward, momentum will return to the construction sector and moderate growth in projects entering planning will return."

After decreasing throughout the quarter, the Index rallied and gained 11% in September, with commercial planning increasing by 13% and institutional increasing 8%. "The gain in the Momentum Index and its components in September is certainly good news and a sign that owners and developers are looking past the current concerns over pricing, Delta, and politics and are moving forward with projects to meet demand. This does not mean there are no problems ahead for the sector. Month-to-month volatility in the data is likely to remain for some time."

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 July was up 9% year over year but down 5% from June. August was up 21% year over year, and down 14% from July. Rounding out the quarter, September was up 6% year over year and 8% over August.

> ELFA President and CEO Ralph Petta said, "Originations in the equipment finance industry continue to tick up, with September new business volume showing good growth compared to the same period last year. Supply chain disruptions and inflation concerns continue, with the Fed poised to gradually ease its asset purchases in the near term. For now, liquidity is abundant and businesses are acquiring the productive equipment necessary to respond to customer demand in a variety of market sectors."

The Equipment Leasing & Finance Foundation's Monthly Confidence Index (MCI-EFI) decreased from 72.9 in July to 66.6 in August and to 60.5 in September.

> "The delta variant is causing some slowdown in certain sectors which will delay, but not derail the recovery of these industries. Other sectors that have seen strong demand but were unable to fulfill all orders due to severe labor shortages are optimistic more workers will return now that the federal unemployment bonus has expired. We expect a robust fourth quarter and are optimistic the momentum will continue into early next year. Future inflation remains the great unknown, and the outcome of the proposed $3.5 trillion infrastructure bill will be a key determinate in whether we experience only short-term inflation or several years of inflation well above the Fed's target rate." - Bruce J. Winter, President, FSG Capital, Inc.

American Rental Association
During its event in Las Vegas, the American Rental Association released an updated third quarter forecast. In its report, it anticipates revenue in 2021 to increase 3% over 2020. The outlook includes revenue for equipment rental in construction/industrial and general tool segments.

> "The updated third quarter forecast released by ARA shows equipment rental revenue to exceed $47.6 billion in 2021, a 3 percent increase compared to 2020. While that number is slightly less than the second quarter forecast, 2022 revenue now is expected to grow at a 9.9 percent clip to reach $52.4 billion, which will be a record for the equipment rental industry, topping the $50.9 billion recorded in 2019. The forecast also calls for equipment revenue increases of 5.5 percent in 2023, 2.5 percent in 2024 and 3.3 percent in 2025 to reach $58.6 billion. Construction equipment rental revenue leads the way with a 12.3 percent increase expected in 2022 to reach $38.7 billion while the general tool segment is forecast to grow 3.7 percent in 2022 to $13.66 billion." – Summary provided by Rental Equipment Register

Institute for Supply Management's Manufacturing PMI®

Institute for Supply Management's (ISM®) Manufacturing PMI® continued its growth throughout Q3. In July, the Manufacturing PMI was at 59.5%, a slight drop from June (60.6%). August's PMI edged up to 59.9%, .04% growth from July. Closing out Q3 in September, it's 16th consecutive month of growth, the PMI came in at 61.1%.

> "Manufacturing performed well for the 16th straight month, with demand, consumption and inputs registering month-over-month growth, in spite of continuing unprecedented obstacles and ever-increasing demand. Panelists' companies and their supply chains continue to struggle to meet demand due to difficulties in hiring and a clear cycle of labor turnover, as workers opt for more attractive job opportunities. Disruptions from COVID-19, primarily in Southeast Asia, continue to have an impact on many industry sectors. Congestion at ports in China and the U.S. continues to be a headwind, as transportation networks remain stressed. Demand remains at strong levels, despite increasing prices." - Timothy R. Fiore, CPSM, C.P.M., Chair of the Institute for Supply Management® (ISM®) Manufacturing Business Survey Committee

Obstacles aside, ISM reports the biggest manufacturing industries experienced moderate or strong growth in September. This includes Petroleum & Coal Products; Computer & Electronic Products; Chemical Products; Food, Beverage & Tobacco Products; Fabricated Metal Products; and Transportation Equipment.

Prices are down for lumber, scrap steel, and wood, but most commodities have increased in price and remain in short supply. Increased pricing has hit Aluminum & Aluminum Products, Electrical Components & Motors, Temporary Labor, Logistic Services, Plastic, Rubber-Based Products, and Steel (hot rolled, cold rolled, galvanized) & Steel Products. And, unsurprisingly, short supply has impacted these same commodities.

ISM's Production Index, also in its 16th consecutive month of growth, ended Q3 at 59.4%. ISM reported 14 industries reported production growth in September, including Petroleum & Coal Products; Machinery; Transportation Equipment; Chemical Products; Fabricated Metal Products; Primary Metals; Computer & Electronic Products; Electrical Equipment, Appliances & Components; and Miscellaneous Manufacturing.

Further, the ISM Prices Index ended Q3 at 81.2, up from August's 79.4. Ultimately, until the scarcity of materials wanes, the pricing index will climb.

Government: Infrastructure Bill

After weeks of stalemate, the H.R. 3684 – Infrastructure Investment and Jobs Act passed Congress. You may recall it was originally presented as the American Jobs Plan in early March with a tag of $2.25 trillion, later introduced in June and passed the Senate in August. Although lower than its original tag, the now $1.2 trillion infrastructure package will provide $550 billion in federal investments in U.S. infrastructure over 5 years.

Funds include approximately $110B for roads and bridges, $65B for electric grid/power infrastructure, $66B for passenger and freight rail, $65B for broadband investments, $39B for public transit, $25B for airports, $21B for environmental remediation, and $17B for ports and water ways.

Much was left out of the bill, including $100B for workforce development. Arguably, a depleted workforce is one of many frustrations the nation faces right now, with tradesman and construction companies certainly sharing significantly in the pain.

Beware, despite an infusion of cash in public construction, delays and payment issues will remain if staffing and material shortages continue. These payment issues may not materialize in the Lien Index immediately, as public construction relies heavily on payment bonds for payment assurances.

To learn more:

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Statistics reflect information available at the time of Lien Index release date.