The Lien Index

2021 Q4

The Lien Index

Executive Summary

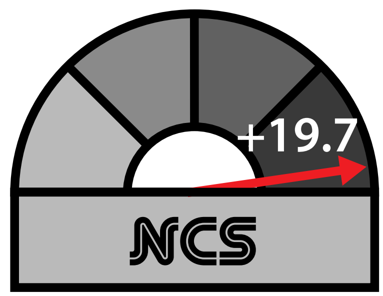
For over 50 years, NCS has been the foremost authority in secured transactions. As the premier mechanic's lien filer in North America, we provide services throughout the U.S. and Canada and across a myriad of construction industry verticals. Our extensive footprint, paired with decades of experience, 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 Q4 Lien Index Score

The Lien Index jumped to 19.7% in Q4. Throughout Q4, national mechanic's lien activity rose across all regions, though most significantly in the Midwest. The increased lien activity was as expected, and we anticipate high lien activity to continue into Q1 2022. Material costs, supply chain breakdowns, and labor shortages are continuing to pressure the industry and impede production schedules, and while the suggestion of an increase in interest rates in 2022 may combat inflation it will likely strain cash flow.



Lien Index Key Influences

Projects

- Construction Backlog Indicator rebounded in Q4.
- Architecture Billings Index ended 2021 with 11 months of growth.
- Material and labor shortages remain primary concerns.

Spending

- Total construction spending rose throughout the second half of 2021.
- Private construction spending continued a steady increase.
- Public construction spending declined in December after a flat start to Q4. Expect growth in 2022.

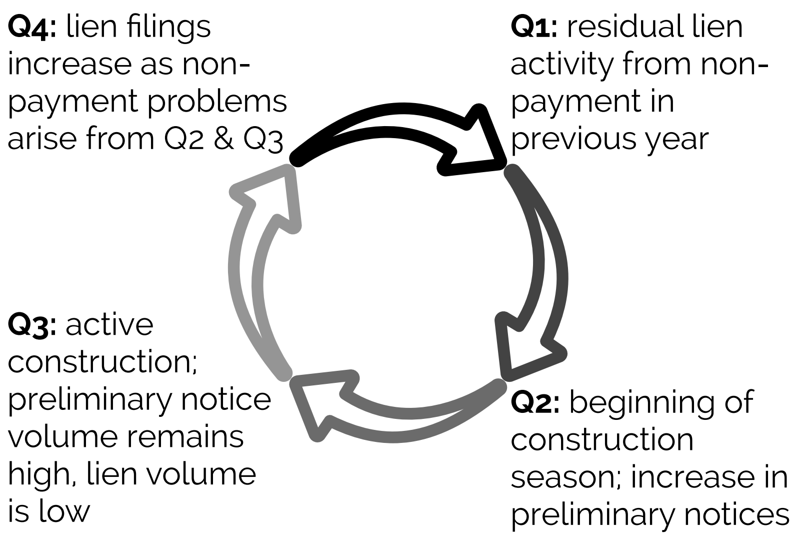
Workforce

- Total construction employment ended Q4 at its highest for 2021.
- After several months of decrease, total construction unemployment inched up slightly by year end.
- Nonresidential construction employment jumped from August, ending high in December.

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.

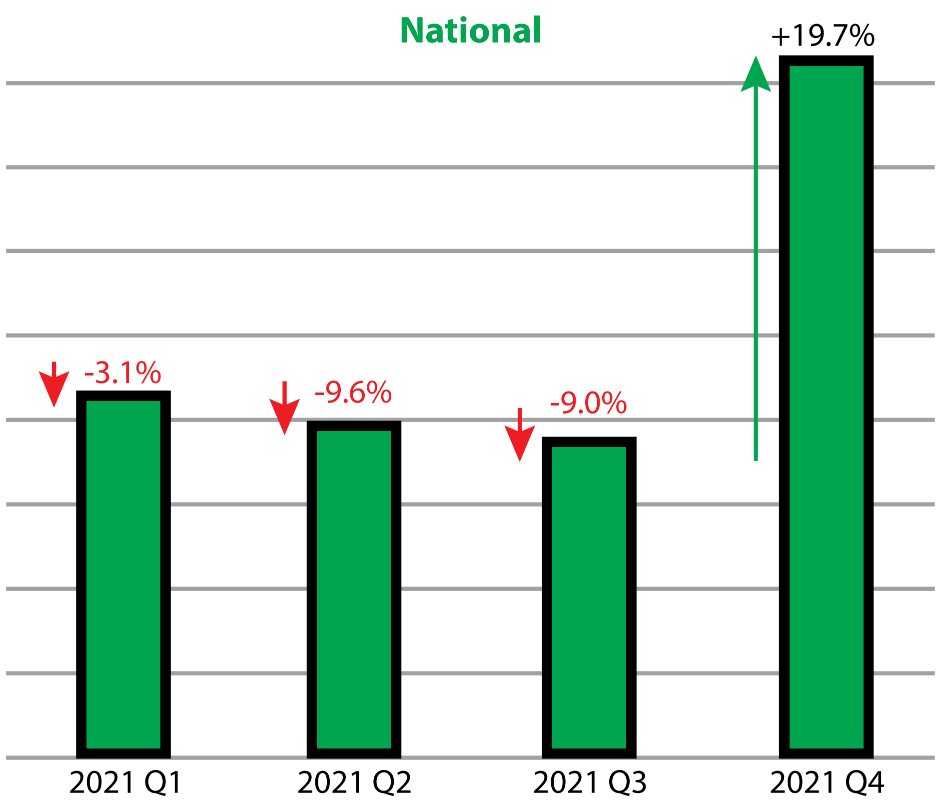
Unfortunately, mechanic's lien filings are rarely presented as risks via credit reports, and they are therefore often neglected in the credit decision process. A review of mechanic's lien filings may uncover significant financial woes. If a company has been party to several mechanic's lien filings it 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 Q4 2021 Lien Index Score

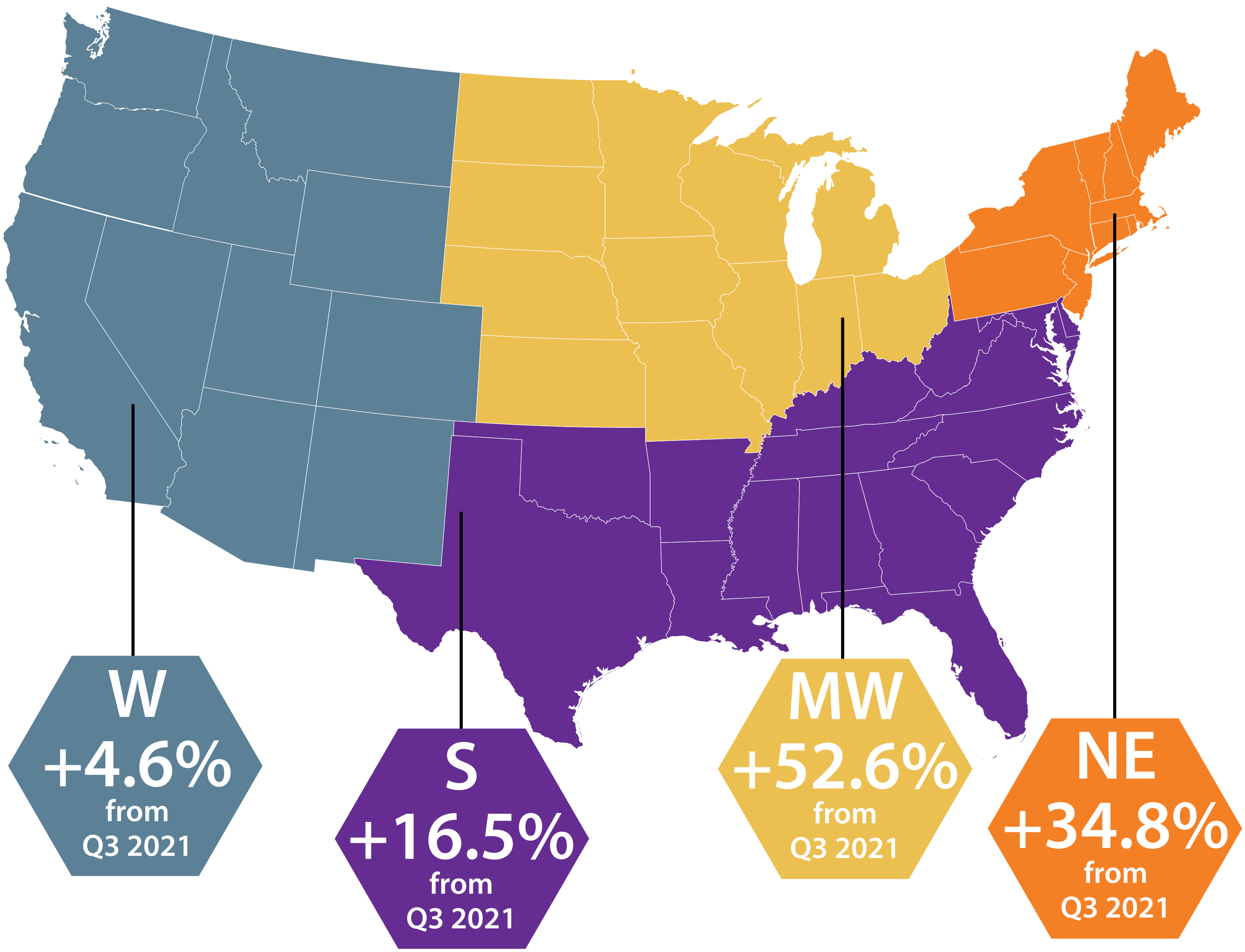
The Lien Index jumped to 19.7% in Q4. Throughout Q4, national mechanic's lien activity rose across all regions, with the most significant spikes in the Midwest and the Northeast. Although it is a significant increase over Q3, it wasn't entirely unexpected. Material costs, supply chain breakdowns, and labor shortages are continuing to pressure the industry, impeding production schedules and cash flow. We expect to see high lien activity through Q1 2022 and likely inching into the beginning of Q2 2022.

National Mechanic's Lien Data

In review of 2021, we see lien activity reacclimating to a typical cycle (i.e., Q1 & Q4 high lien activity and Q2 & Q3 low lien activity). While the jump from -9.03% in Q3 to 19.7% in Q4 seems extreme, it's within the expected range. The increase does present a wild card though, and as we move through the first half of 2022, we may see this increased activity holding steady into Q2 instead of dropping off at the end of Q1 as we would expect.



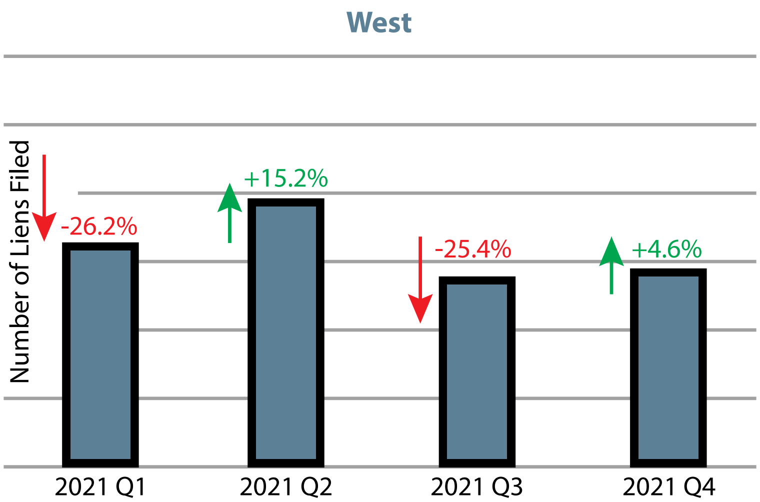
Regional Mechanic's Lien Data

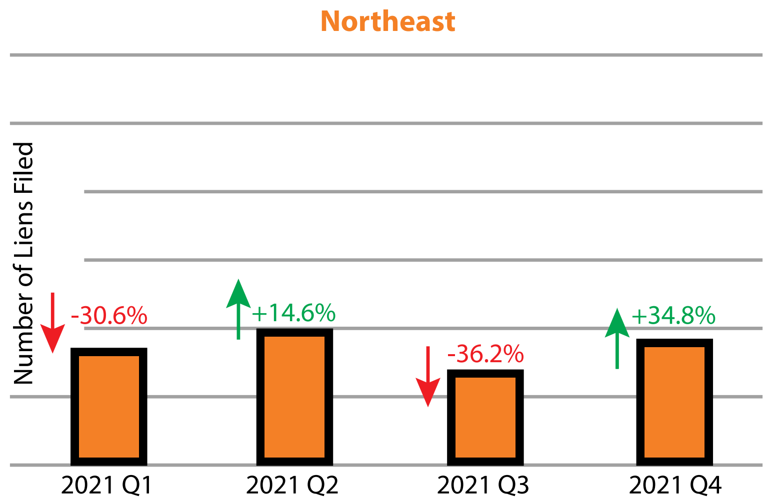


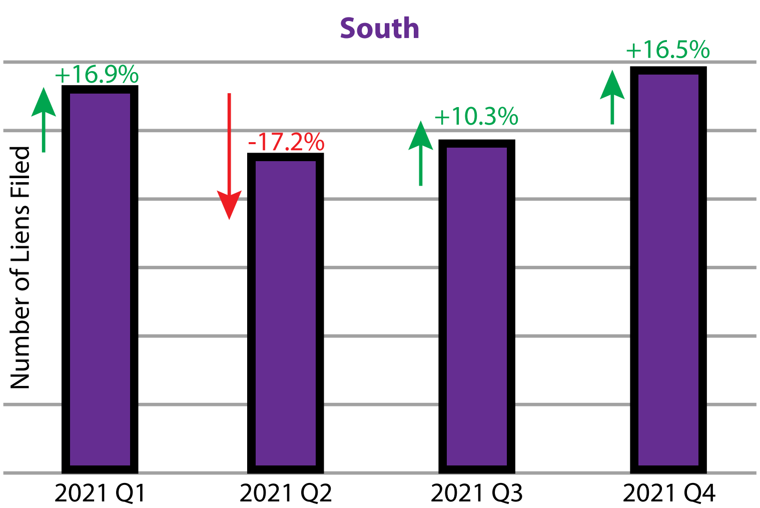
As expected, all regions experienced an increase in lien activity in Q4. The Midwest saw the greatest increase, followed by the Northeast, the South, and the West, respectively.

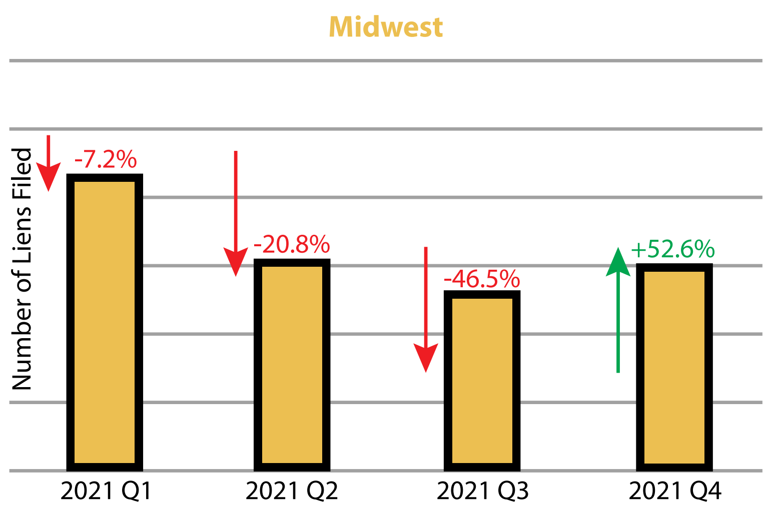
The Midwest's lien activity made a dramatic leap in Q4 to +52.63%, ending its quarter-over-quarter declines since 2020.

Breaking down Q4 2021 national lien activity by region, the Midwest and Northeast ousted the South's top seat in Q3. The Northeast ended Q4 at +34.81%. The South continued its increase, but at a slower pace coming in at +16.49%. The West recorded the lowest increase in lien activity at +4.55%.









In reviewing state specific activity, Texas continues to be the state with the highest lien activity, followed by Florida, California, New York, and Colorado. Within each region, the top three states for lien activity are: Texas, Florida, and Georgia in the South, California, Colorado, and Utah in the West, New York, New Jersey, and Massachusetts in the Northeast, and Illinois, Ohio, and Michigan in the Midwest.

A Look Ahead

Material prices, material shortages, labor shortages, and additional COVID-19 variants; when will it end? We continue to experience longer-term economic effects of the pandemic.

Economists agree, inflation is likely here to stay, at least through 2022. In December, the Federal Reserve indicated multiple interest rate hikes are coming in 2022 to try and combat inflation.

Although we seem to be bombarded by challenges, the construction industry is anticipating a 4%-6% rise in construction starts in 2022. As we move through Q1 2022, expect to see these new project starts partnered with new contractual language. All parties are working to revamp contractual terms to account for diminishing margins, thanks in large part, to the costs associated with materials and labor.

In Q1 2022 the Lien Index is expected to remain high. Expect an increase in lien activity as contractors, suppliers, and distributors navigate the boundaries of their existing contracts against the high cost and scarcity of labor and materials. Additionally, projects will be wrapping up, and undoubtedly revealing project-long-payment-issues.

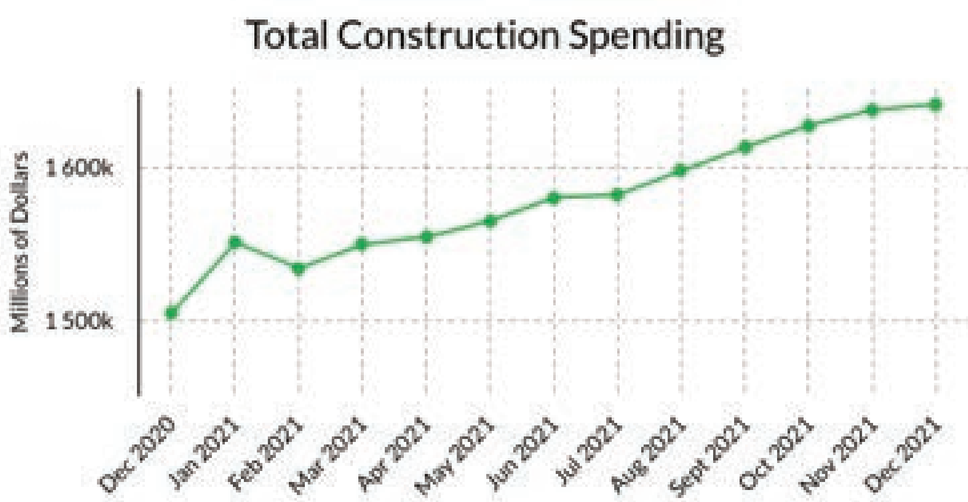
Be Prepared

- Carefully identify and evaluate credit for all parties within the ladder of supply. Construction is wrought with payment issues because the credit relationship is between more than you and your customer; it includes every party between you and the project owner. Timely payment is at the mercy of the weakest link in the payment chain.
- Obtain as much information as possible on the project and all parties within the ladder of supply. Recognize these large-scale projects will likely cover multiple parcels across multiple states.
- Serve preliminary notices on both public and private projects to secure bond claim and mechanic's lien rights respectively.
- Continue to monitor activity on your existing projects/customers. We are seeing an uptick in fund shifting (project to project), which is escalating payment issues. As you prepare and file mechanic's liens, ensure you have sufficient documentation to support your claim.

$ SPENDING Lien Index Key Influences: Spending

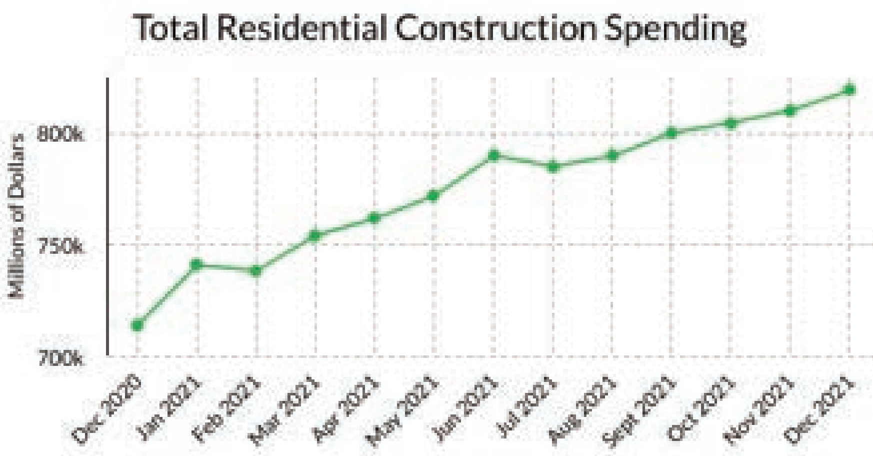
Total Construction Spending

According to data from Federal Reserve Bank of St. Louis (FRED), total construction spending increased throughout 2021. Q4 ended with October at $1,626.4B, November at $1,636.5B, and December inched up to $1,639.9B.



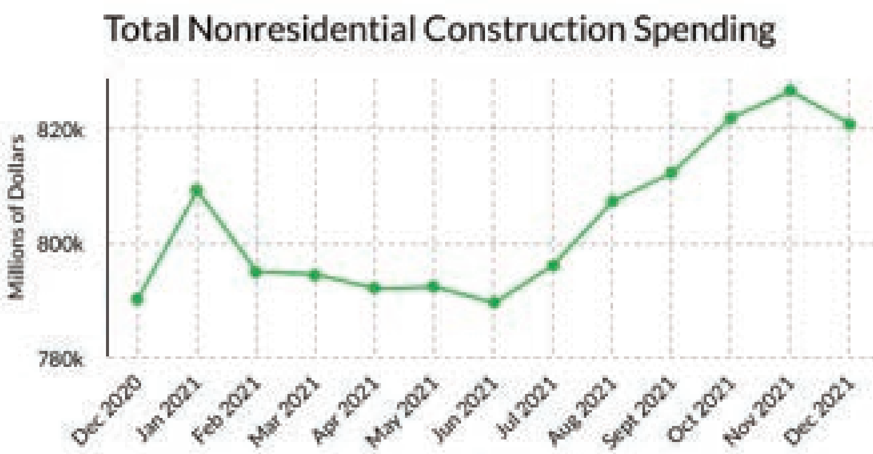
Residential Construction Spending

In general, 2021 residential construction spending trended upward, after recovering from a slow start in Q1. Residential construction spending in October was $804.6B, an increase over September. In November, spend climbed to $810.1B, and ended Q4 at $819.1B in December.



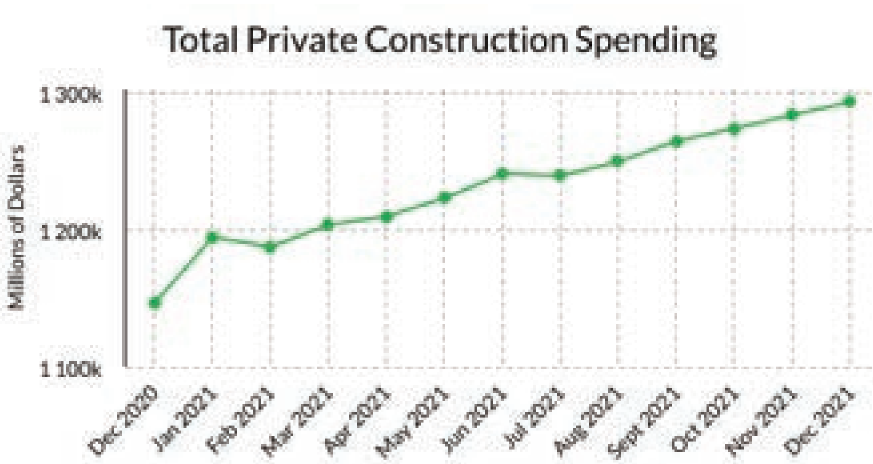
Nonresidential Construction Spending

Nonresidential construction spending increased month over month from June to November but dipped in December. A review of Q4 spend shows October spend was $821.8B, jumped in November to $826.4B, and dropped to $820.7B in December.



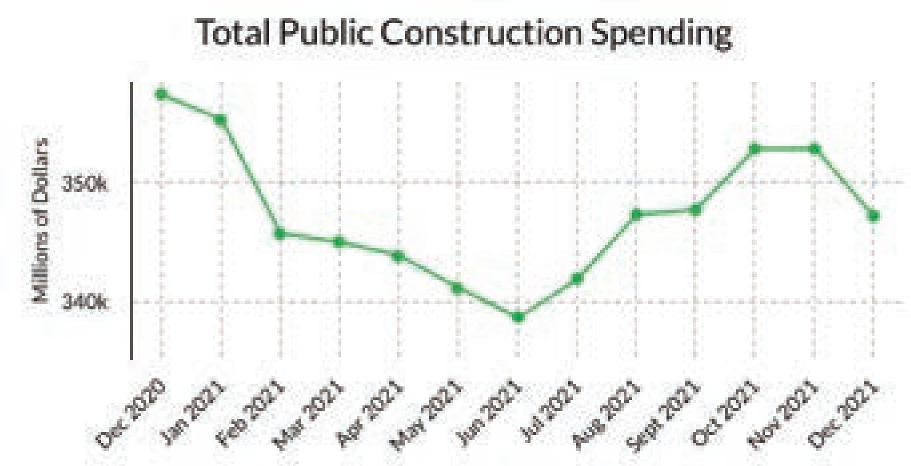
Private Construction Spending

Private construction spending continued its general upward trajectory. October spend was $1,273.7B, November was $1,283.8B, and December rounded out the year at $1,292.9B.



Public Construction Spending

Public construction spending had a bit of a tumultuous year, ending Q4 down. October was $352.68B and remained virtually unchanged with November coming in at $352.72B. Spend dropped in December to $347B. With the passage of the infrastructure bill, the spend in 2022 should show an overall increase.



Bankruptcy Information

After months of low activity, bankruptcy filings rose 1.8% in October. According to Epiq, despite the slight increase, the overall percentage of new filings remains lower than pre-pandemic levels. Total Chapter 11 filings increased by 21.1% in October and Chapter 11 Subchapter V filings were up 16.7%.

November filings dropped 5.6% from October. This drop included a 10.3% decline in commercial filings. Total Chapter 11 filings, including Subchapter V, were down 29.1%.

In review of 2021, and after another monthly decline of 4.7% in December, total new filings across all chapters were down 24.2% for the year. Though total filings were down, there was a spike in Chapter 11 filings with a 56.1% increase over November.

> "December individual bankruptcy filing activity continued to trend down as has been the pattern since the COVID-19 global pandemic manifested in the U.S. in March 2020. Commercial filings spiked up sharply month-over-month, but levels continue to be way off pre-COVID-19 levels," said Chris Kruse, senior vice president of Epiq Bankruptcy Technology.

It is inevitable, there will be an uptick in business bankruptcies. There will be mergers and acquisitions which may stave off filings for a bit. But soon, inflation is going to batter profit margins and business cash reserves will deplete. Though infrastructure monies are coming in 2022, it won't be enough to salvage the businesses who can't afford to compete in a market where material prices and labor shortages continue to soar.

U.S. Bureau of Labor Statistics Producer Price Index and Consumer Price Index
Unsurprisingly, price indexes climbed throughout Q4. U.S. Bureau of Labor Statistics Producer Price Index (PPI) rose .6% in October, 1% in November, and .2% in December. The PPI News Release reports "…final demand prices moved up 9.7% in 2021, the largest calendar year increase since data were first calculated in 2010." The Consumer Price Index (CPI) increased .9% in October, .8% in November, and .5% in December. The CPI has risen 7% over the last 12 months.

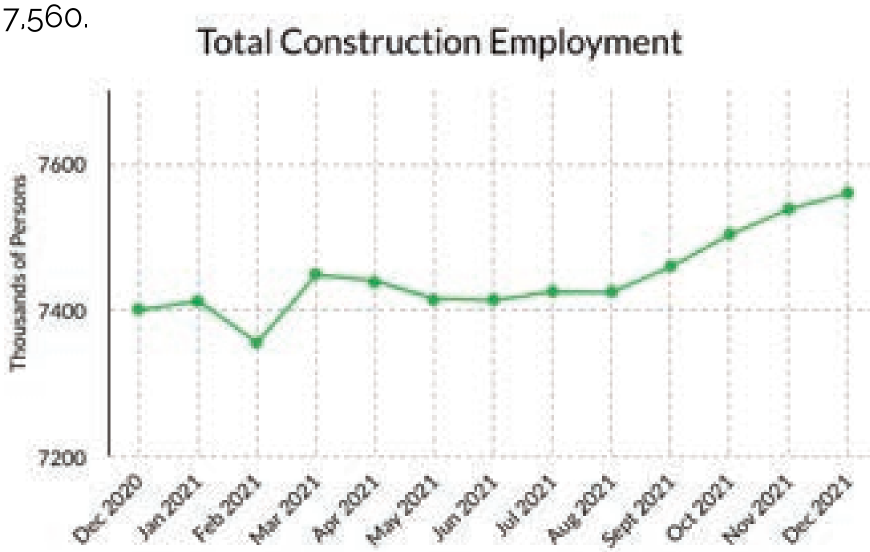
U.S. Chamber of Commerce Commercial Construction Index (CCI)
In Q4, the CCI fell a point to 65. Concerns surrounding materials, labor, and adequately adjusting profit margins top the list.

> "A majority (62%) of contractors report high difficulty finding skilled workers, up from 55% who said the same last quarter (and up 20 points year-over-year). Over half (56%) of contractors report a high degree of concern about their workers having adequate skill levels, up six points from last quarter and 20 points year-over-year.
>
> Almost all (95%) contractors are experiencing at least one product shortage, up from 93% last quarter and up 24 points (71%) who said the same a year ago. The product which most contractors are experiencing a shortage in is steel (27%), followed by roofing at 19%. Contractors still see growing profits.
>
> Contractors expecting an increase in profit margin over the next 12 months stayed the same (24%) as last quarter, while those expecting profits to remain the same rose three points to 66%. Ten percent expect their profit margin to decrease over that time (down three points from Q3)."

WORKFORCE

Lien Index Key Influences: Workforce

Total Construction Employment
After a relatively flat Q2 and first half of Q3, total construction employment began its ascent in September. In Q4, total construction employment rose to 7,503 in October, 7,538 in November, and ended the year at 7,560.

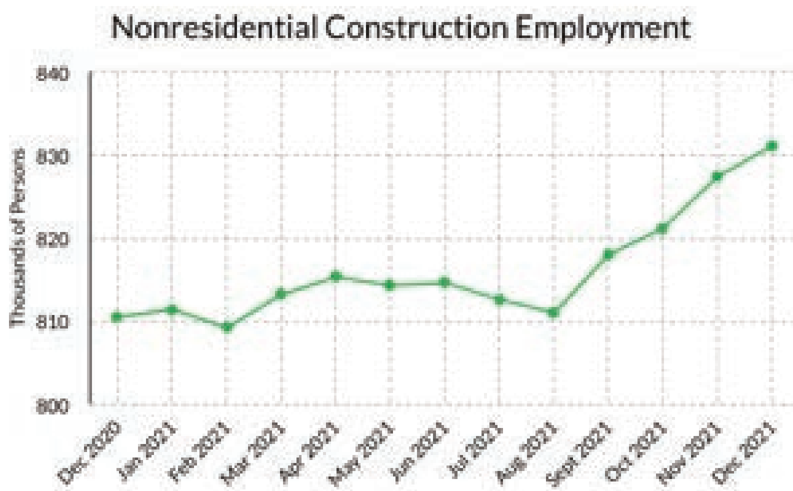


Total Construction Unemployment

Total construction unemployment declined throughout Q2, Q3, and into the first part of Q4, then rose in November and December. The unemployment rate was 4% in October, 4.7% in November, and 5% in December.

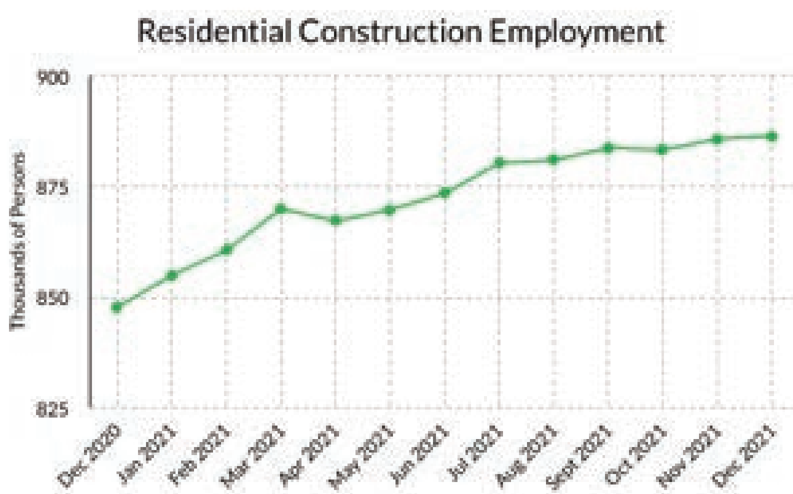
Nonresidential Construction Employment

After a low in August, nonresidential construction has increased month over month. Rising to 821.2 in October, 827.4 in November, and 831.1 in December.



Residential Construction Employment

Residential construction employment climbed incrementally throughout Q4 after a slight dip from September to October. October ended at 883.2, November ended at 885.7, and in December the number rose to 886.4.



PROJECTS

Lien Index Key Influences: Projects

Architecture Billings Index
AIA's Architecture Billings Index (ABI) remained strong throughout Q4, and although it did experience a dip mid-quarter, it spent 2021 at highest levels since its inception. The slight descent from Q3 into Q4 began with an October score of 54.3. In October, ABI reported "In addition, inquiries and the value of new design contracts, both indicators of future work at firms, strengthened in October, meaning that clients are continuing to both start conversations about new projects and are signing contracts to begin those projects in the coming months. Although concerns about staffing, inflation, and construction material prices and availability remain, they have not yet acted as a major deterrent to projects at this time."

In its 10th consecutive month increase, November remained positive but certainly lower than summer, coming in at 51.0. Experts agree, the significant growth seen in the summer months is tough to maintain. While the numbers in November dipped, it certainly does not spell doom.

> "An ABI score of 51.0 for the month still means that the majority of architecture firms saw billings growth at their firms this month, but that fewer are seeing growth now than earlier this year. However, a growth rate like what was experienced this past spring and summer is difficult to maintain for long, and firm billings have now shifted closer to the pace of growth seen in previous recovery periods. In addition, firms continue to report a very strong amount of work in the pipeline, with inquiries and the value of new design contracts remaining near all-time high levels."

December's score was 52.0, ending 2021 on a high note. Throughout 2021, the ABI experienced growth in every month except January, and although concerns around material and labor shortages remain, folks are hopeful.

> "And despite a variety of concerns related to the omicron variant; prices/availability of construction materials; and labor shortages, firms also continued to report a robust supply of work in the pipeline, with inquiries into new work and the value of new design contracts both remaining strong, and backlogs remaining near the highest levels ever reported since we started collecting this data in 2010, at an average of 6.5 months."

Associated Builders and Contractors' Construction Backlog Indicator
Associated Builders and Contractors' (ABC) Construction Backlog Indicator (CBI) rebounded to 8.1 months in October from its Q3 contraction. However, the rebound appears to be at the expense of profit margins, according to ABC Chief Economist, Anirban Basu.

> "After declining for two months, nonresidential construction backlog bounced back in October," said Basu. "But some of the renewed momentum appears to be at the expense of profit margins. ABC's Construction Confidence Index indicates that the average contractor expects profit margins to dip over the next six months. The implication is that contractors are finding it difficult to pass along all the cost increases caused by higher materials prices."

CBI increased to 8.4 months in November. "Optimistic expectations are a testament to how strong deal flow remains in stimulus-driven America," said Basu. "The infrastructure package passed in November is another reason for optimism, particularly for contractors who work in segments like roads and bridges, water and sewer and mass transit. It is likely that industry circumstances will improve further in 2022, especially if supply chain disruptions and input shortages become less severe, which many economists anticipate by the second half of next year."

Q4 ended with the CBI falling slightly to 8.2 months, but demand for services remains strong, according to Basu. "Demand for construction services in America remains strong. Contractors have been upbeat about sales and employment prospects for months. What changed in December is that a growing fraction of contractors now believe that profit margins will rise during the next six months despite rising costs due to labor shortages and volatile materials prices."

As current interest rates remain low, liquidity remains high, and demand continues, the industry is set for growth in 2022. However, inflation, worker shortages, and their impacts on existing projects, payment and performance issues are surfacing. As mechanic's lien activity spiked in Q4, we are witnessing the true effects of these impacts. Although there is hope that an increase in interest rates will combat inflation, bear in mind that as interest rates rise, companies' liquidity will decrease. The strain on cashflow/reduced liquidity will lead to further increase in mechanic's lien activity. Credit professionals need to tighten credit policies and closely monitor aging reports. This is not the time to "let the aging report go until next week."

Dodge Data & Analytics

Dodge Data & Analytics (Dodge) reported the Dodge Momentum Index started Q4 with a 10% jump in October from September. Commercial planning climbed 14% and institutional planning increased 3%. Dodge noted the increase was driven by planning in warehouses, offices, and healthcare structures. Further, "The value of nonresidential building projects entering planning has staged a solid recovery this fall. It has lifted the Momentum Index to its highest level in nearly 14 years, following a near-moribund summer of activity. The commercial sector has shown strength, having reached its highest level since the inception of the Index."

Unfortunately, the momentum did not continue in November as the Index fell 4%, with commercial planning falling 8%, with a bright spot of a 5% increase in institutional planning. As material prices and labor shortages continue to disrupt the industry, Dodge compared the trends of drastic gains and losses to a sawtooth pattern, which often occurs in volatile times. Despite the drop this month, the Index holds steady at a 14-year high.

> "Planning data continues to suggest a healthy level of construction to come in 2022. However, due to higher prices and shortages of labor, actual growth is expected to be modest. The new Omicron variant for COVID-19, and its potential impact on economic growth, highlights the tremendous uncertainly the construction sector will face over the coming year."

In December, total construction starts were flat, with residential construction starts up 4%, nonresidential building starts up 3%, and nonbuilding starts down 12%. Despite flat activity, construction starts climbed 12% in 2021 over 2020.

> "The increase in construction starts was impressive given the many challenges the industry faced during the year. Higher material prices, labor shortages, and multiple waves of COVID infections threatened to dampen the recovery," stated Richard Branch, chief economist for Dodge Construction Network. "However, construction remained resilient and persistent throughout the year in the face of these difficult issues. While these challenges will remain in 2022, the industry is well-positioned to make further gains fed by a growing pipeline of nonresidential projects waiting to break ground and the infusion of money directed towards infrastructure."

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) was up 16% in October, then fell 26% in November, and jumped 49% in December.

> "…MLFI-25 reflects both a monthly and cumulative year-over-year increase in business equipment investment as our economy recovers from the impact of the COVID pandemic. While there are headwinds—supply chain disruptions, increasing labor and material costs, and now the potential for rising borrowing costs to offset inflationary pressures—businesses in many capital-intensive industries remain poised to capitalize on pent-up demand as soon as equipment is available." - Kirk Phillips, President and CEO, Wintrust Commercial Finance

The Equipment Leasing & Finance Foundation's Monthly Confidence Index (MCI-EFI) increased to 61.1 in October, 64.6 in November, and decreased to 63.9 in December.

> "The near-term future of the equipment finance industry shows promise for continued expansion. As infrastructure bills are passed and implemented there will be a demand for many asset classes from construction through IT platforms. This, of course, will need to be supported by increased manufacturing capacity to build all the required capital goods. I do have concerns about the political atmosphere that currently exists in the U.S. that may slow down or even kill the entire infrastructure bill, and secondly, the supply chain issues that have bottlenecked the product delivery system." - Daniel J. Krajewski, President and CEO, Sertant Capital, LLC

Institute for Supply Management's Manufacturing PMI®
Institute for Supply Management's (ISM) Manufacturing PMI® rallies for its 19 consecutive month of growth. Although October dipped .3% over September, November reclaimed the loss and came in at 61.1%, and December dipped to 58.7%.

> "The U.S. manufacturing sector remains in a demand-driven, supply chain-constrained environment, with indications of improvements in labor resources and supplier delivery performance. Shortages of critical lowest-tier materials, high commodity prices and difficulties in transporting products continue to plague reliable consumption. Coronavirus pandemic-related global issues — worker absenteeism, short-term shutdowns due to parts shortages, employee turnover and overseas supply chain problems — continue to impact manufacturing. However, panel sentiment remains strongly optimistic…" says Timothy R. Fiore, CPSM, C.P.M., Chair of the Institute for Supply Management® (ISM®) Manufacturing Business Survey Committee.

ISM® reports the biggest manufacturing industries registered moderate or strong growth in December:

- Chemical Products;
- Fabricated Metal Products;
- Computer & Electronic Products;
- Food, Beverage & Tobacco Products;
- Transportation Equipment; and
- Petroleum & Coal Products.

Respondents continue to indicate robust activity, increased backlogs, but material shortages are impacting orders.

The saga lingers as commodity prices continue to climb. Lumber prices had dropped in Q3, but it was short lived as costs increased by the end of the 2021. Prices for aluminum, electrical components, diesel, resin-based products, and steel products also rose. Short supply, an obvious recurring theme, burdens those needing cooper products, electrical cables and components, and steel.

ISM®'s Production Index, also in its 19th consecutive month of growth, ended Q4 at 59.2%. ISM reported 10 industries reported production growth in December, including:

- Furniture & Related Products;
- Plastics & Rubber Products;
- Textile Mills; Paper Products;
- Chemical Products;
- Machinery;
- Computer & Electronic Products;
- Food, Beverage & Tobacco Products;
- Transportation Equipment; and
- Miscellaneous Manufacturing.

In line with increased costs/decreased supply, four industries reported a decrease in production including wood products, fabricated metal products, and primary metals.

Government: Infrastructure Bill
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 as staffing and material shortages continue. These payment issues may not materialize in the Lien Index immediately, because public construction relies heavily on payment bonds for payment assurances.

Large scale projects, as we would expect to see from infrastructure investment of this size, are frequently owned/managed under Public Private Partnerships (P3). Generally, a P3 is an agreement between a private entity & public entity for the construction of a project, whereby the private entity provides the funding which is often lacking in the public sector. P3s can be incredibly beneficial, especially in financing large construction projects. Many states have statute which specifically addresses P3s and the payment remedies that may be available to lien or bond claimants.

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