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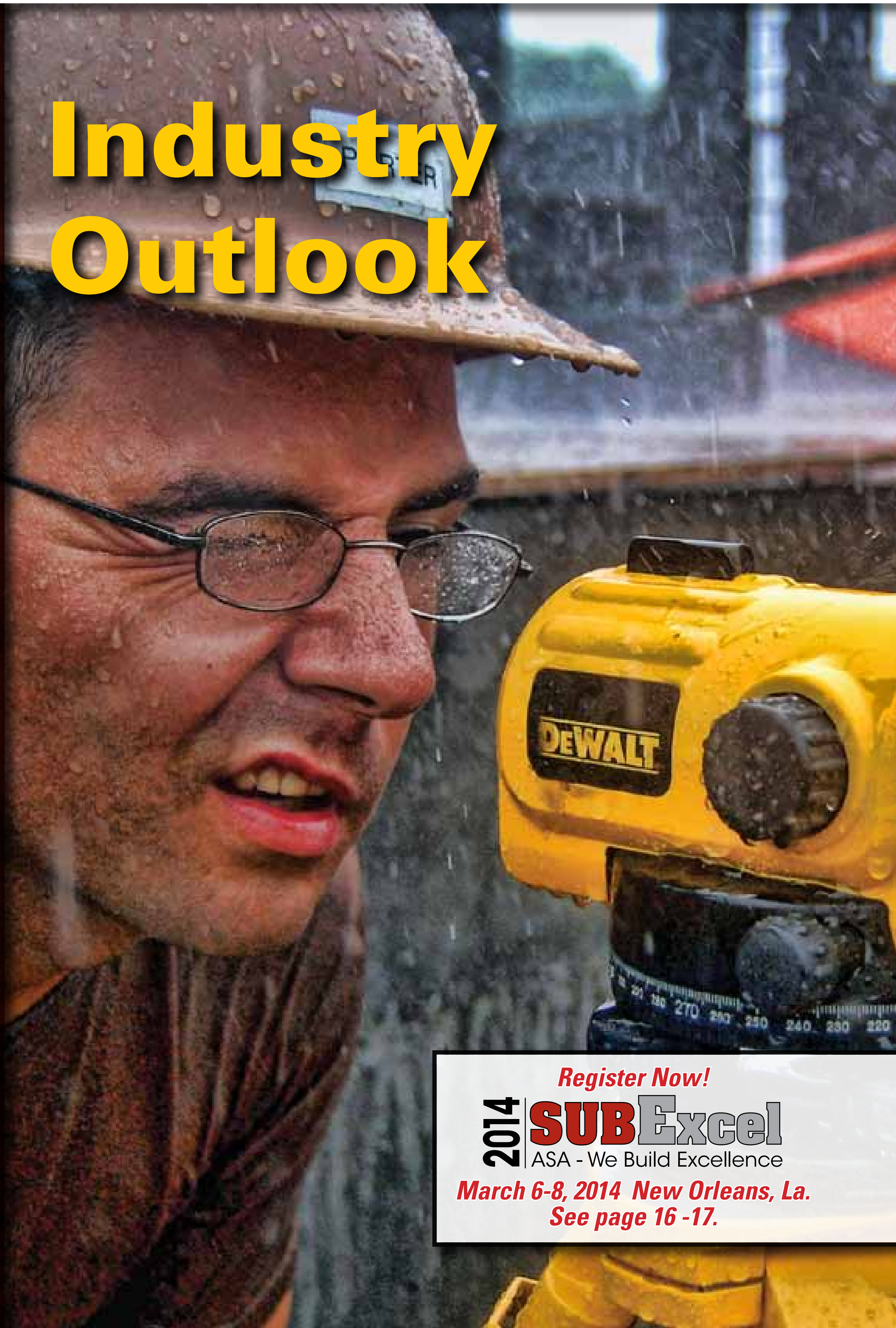

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How Mechanic's Liens Can Off-Set Financial Risk in Challenging Economies

by Scott Wolfe Jr.

After years of working through an economic flatline, the construction industry is starting to show signs of life. Many economists are seeing sparks of an economic rebound and expect promising growth in 2014.

Regardless of whether the construction marketplace stays the same, gets better, or gets worse, subcontractors must be careful in the years ahead. The challenges of a bad or flat economy are familiar, but surprisingly, studies show that rebounding economies are actually more financially risky than declining economies.

Heightened Financial Risk

When business is humming along and the construction market is strong, avoiding financial risk is difficult, but manageable. Financial risk is more unpredictable, however, when the economy is "challenging," that is, bad, flat or rising. Many people understand the downside to bad or flat economies. Fewer understand the risks of *rising economies.* An economy that is rebounding is actually quite dangerous.

For example, a sudden increase in business opportunities presents high demand for cash to meet those needs. Unfortunately, most companies are cash poor after suffering through years of a recessed economy. The clash between a cash-needy rebound economy and cash-poor, recessed-beaten companies creates bad situations. The sudden increase in business opportunities also requires the market scale to meet that demand, which presents practical problems.

These macro problems, and others, have real-life symptoms that will be felt by the market. Contractors may have a difficult time getting permits or putting together a labor force, resulting in costly delays. Contractors may also run out of cash or may see their own subcontractors running out of cash, which presents obvious problems.

As 2013 comes to a close and this country enters 2014, the construction market is going to face a challenging economy. It will either stay the same, get worse, or get better. Regardless, it will be riskier than usual.

Navigating the Challenges

Financial risk is not new to the construction market. Subcontracting companies, however, must be extra alert when cash-flow challenges are predicted, because they are furthest away from the cash in the contracting chain and most at risk to payment-flow problems.

Protect and Perfect Lien Rights

A recent survey from the Construction Financial Management Association found that "cash-strapped public and private owners are shifting greater [financial] risk onto contractors through onerous deal terms."

This is a reality of the modern day construction market exasperated by the risks of a challenging economy. The only way for subcontractors to insulate themselves from these risks, and to shift the risk back up the contracting chain, is with mechanic's lien rights.

Mechanic's lien laws exist in every state for the explicit purpose of protecting subcontractors against payment-flow abuses and non-payment. These instruments act to secure a subcontractor's contribution to the project. Subcontractors without mechanic's lien rights are vulnerable to payment delays, bankrupt parties in the contracting chain, and strong-arm tactics from developers and general contractors. Those with mechanic's lien rights are not vulnerable to these risks. It is that clear-cut and that simple.

The linchpin, therefore, is the preservation of those lien rights. While every state provides subcontractors with a mechanic's lien remedy, the right to use that remedy must usually be preserved. This requires subcontractors to send a preliminary notice document (in the mail) to the property owner and the general contractor. These must typically be sent

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- ***Subcontractors can shift risk back up the contracting chain with mechanic's liens.***
- ***Mechanic's lien laws exist in every state to protect subs against non-payment.***

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within a certain period of time (usually 20 days or less) from the start of work.

These preliminary notices not only preserve the right to later file a lien if necessary, but they also cause a subcontractor's payment applications to get prioritized over pay applications from subcontractors that did not preserve their rights.

1-2-3 Steps

1. Don't Be Afraid to Send Notice Every Time. In most states, if you don't send preliminary notice, you won't have any mechanic's lien rights in the event of non-payment. Savvy subcontractors understand this and send preliminary notice on every single project. There is no reason to fear sending preliminary notices. These documents are not designed to protect you — they are designed to protect the owner and the general contractor by notifying them of your work. Owners and general contractors receive these notices all the time, and they actually use software products (like Textura) to track these notices. Sending notice gets subcontractors paid.
2. If You Don't Get Paid, Warn Them About Filing A Lien. Sometimes, of course, payment will get delayed. When this happens it is important to respond quickly, since a debt gets more difficult to collect every day that it ages. One way to respond to an unpaid pay application is to notify your customer of your intent to file a mechanic's lien. This acts not only as a "*dunning letter*," but it also fires a warning shot about the use of a lien to collect. These warning shots are enormously effective, with some research showing they result in payment in more than 50 percent of deliveries.
3. Monitor Your Deadline and File Your Lien. If a debt is still not paid, you'll need to escalate it and file a mechanic's lien. Filing a mechanic's lien will secure the debt and practically guarantee eventual payment and usually has the effect of prompting payment quickly. Subcontractors must monitor their upcoming mechanic's lien deadlines to make certain that they file the lien before the deadline. Missing a deadline is fatal to the claim right.

Scott Wolf Jr. is chief executive officer of Zlien, a company that provides software and services to help building material supply and construction companies reduce their credit risk and default receivables through the management of mechanic's lien and bond claim compliance. He is also the founding author of the Lien Blog, a leading online publication about liens, security instruments and getting paid on every account. He is a licensed attorney in six states with extensive experience in corporate credit management and collections law, with a specific emphasis on utilizing mechanic's liens, UCC filings and other security instruments to protect and manage receivables. Wolfe is the chief executive officer and founder of Wolfe Law, and is the author of ***The Lien and Credit Journal****, which zeros in on extending credit and collections management. He can be reached at (866) 720-LIEN (5436) or* **scott@zlien.com**.