Construction Bills: Recent Changes to Construction Laws

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Moving Ahead With Map-21

On July 6, 2012, more than three years after the expiration of the previous federal transportation law, President Obama signed into law the Moving Ahead for Progress in the 21st Century Act (MAP-21), funding more than $105 billion in surface transportation programs for fiscal years 2013 and 2014. "**This measure includes historic reforms—cutting red tape and consolidating or eliminating nearly 70 federal programs**," said Transportation and Infrastructure Committee Chairman Representative John L. Mica (R-FL).[1] Even though the law covers only 27 months, instead of five to six years as is typical with transportation appropriation bills, MAP-21 provides long-needed assurance to states, contractors, and the public that funding will be available for transportation projects through 2014.

After the expiration of the Safe, Accountable, Flexible, Efficient Transportation Equity Act: A Legacy for Users more than three years ago, members of Congress proposed several options for the new federal transportation law, running the gamut from reducing highway and transit programs to fully funding highway projects at the expense of all transit programs. Ultimately Congress passed the bipartisan MAP-21 legislation. The purpose of MAP-21 is to create a streamlined and performance-based surface transportation program that builds on many of the highway, transit, bike, and pedestrian policies and programs in place since the 1990s. The restructuring under the law offers states more flexibility on the use of federal funds, which could result in increased investment in highway, bridge, and pavement projects around the country.

According to Transportation Secretary Ray LaHood,

> This is a good, bipartisan bill that will create jobs, strengthen our transportation system and grow our economy. It builds on our aggressive safety efforts, including our fight against distracted driving and our push to improve transit and motor carrier safety. The bill also provides states and communities with two years of steady funding to build the roads, bridges and transit systems they need.[2]

Program Restructuring

MAP-21 consolidates core highway formula programs into broader core programs. Activities under existing formula programs, including the National Highway System Program, the Interstate Maintenance Program, and the Highway Bridge Program, are consolidated into the following six core programs:

1. National High Performance Program (NHPP)
2. Surface Transportation Program (STP)
3. Congestion Mitigation and Air Quality Improvement Program (CMAQ)
4. Highway Safety Improvement Program (HSIP)
5. Railway-Highway Crossings (set aside from HSIP)
6. Metropolitan Planning

The law eliminates many discretionary programs, but many of the eligibilities from eliminated programs are covered in the six core programs.

Investment

MAP-21 maintains funding levels at fiscal year 2012 levels with minor adjustments for inflation. Therefore, funding of $40.4 billion from the Highway Trust Fund is available in fiscal year 2013 and $41.0 billion is available in fiscal year 2014. MAP-21 also establishes an annual obligation limitation of up to $39.7 billion in fiscal year 2013 and $40.25 billion in fiscal year 2014 for the purpose of limiting highway spending each year.

The law also increases funding for and expands the Transportation Infrastructure Finance & Innovation Act program, which provides federal credit assistance to eligible surface transportation projects. MAP-21 authorizes $750 million in fiscal year 2013 and $1 billion in fiscal year 2014 to pay the subsidy cost to support the federal credit. According to the Federal Highway Administration, the $1 billion authorization in fiscal year 2014 can

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support about $10 billion in actual lending capacity. It is hoped that this increase in credit assistance will spur local investment and boost state construction activity.

Expansion of National Highway System

MAP-21 expands the reach of the National Highway System (NHS), incorporating principal arterials not previously included in the NHS. The NHS now includes 220,000 miles of rural and urban roadways, far beyond just the interstate system. The National Highway Performance Program authorizes an average of $21.8 billion per year to support the NHS, including construction of new facilities, maintenance and operation, and support of efforts to achieve performance goals established for the NHS.

Performance Management

One of the main goals of MAP-21 is to transition the focus of federal highway programs to performance and outcome. MAP-21 establishes national performance goals for safety, infrastructure condition, congestion reduction, system reliability, freight movement and economic vitality, environmental sustainability, and reduction in project delivery delays. States will invest resources and report to the Department of Transportation on efforts to meet localized targets that collectively move the country toward national goals. Inadequate progress in some areas, including key safety measures, interstate pavement conditions, and bridge conditions, will require corrective action by the state.

Streamlining Project Delivery

The average US highway project currently requires 15 years from concept to completion, far more than in any other developed nation.[3] According to Rep. Mica,

> "Shovel ready" became a national joke because projects get bogged down for years in the wasteful, bureaucratic project review process. The dramatic reforms in this measure will get projects moving by cutting the red tape that delays projects across the country and drives up construction costs.[4]

MAP-21 includes significant environmental review reforms that encourage early coordination between agencies and sets a framework for firm deadlines in the environmental review process, with penalties for an agency's failure to make a timely decision. For projects now stuck in the environmental review process, technical assistance will be made available to expedite completion of the process and set deadlines for completion within four years of the notice of intent. Building on the Federal Highway Administration's Every Day Counts Initiative, the law seeks to reduce project costs by reducing the amount of time required for project approvals through the planning and construction phases.

Expedited procedures will permit projects with minimal environmental impact to acquire or preserve right-of-way prior to final environmental approval under the National Environmental Policy Act (NEPA). MAP-21 also expands the number and types of projects that are excluded from the federal environmental review process under NEPA through categorical exclusions. Categorical exclusions may also limit review requirements for projects that receive less than $5 million in federal funds or are less than $30 million with federal funds making up less than 15 percent of the project cost. According to Rep. John Duncan (R-TN), chairman of the House Highways and Transit Subcommittee, MAP-21 "goes further in streamlining environmental rules and regulations than any previous highway bill."[5]

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Transit and the Surface Transportation Program

MAP-21 consolidates several of the Federal Transit Administration's smaller programs and restructures the rail modernization and bus discretionary program into a new State of Good Repair Program, dedicated to repairing and upgrading rail transit systems along with motor bus systems that use high-occupancy vehicle lanes including bus rapid transit.

Under the Surface Transportation Program (STP), an average of $10 billion is available in flexible funds for highway and bridge projects, but also for nonmotorized transportation, transit capital projects, and public bus terminals and facilities. Under the STP, funds are available for electric vehicle charging infrastructure and projects and strategies that support congestion pricing, including electronic toll collection and travel demand management strategies and programs.

Transportation Alternatives Program

As a new program under MAP-21, the Transportation Alternatives Program provides for a number of alternative transportation projects previously funded by a variety of different programs. The Transportation Alternatives Program is funded at two percent of all MAP-21 authorized federal-aid and highway research funds. Funds are to be used for recreational trail programs; safe routes to school programs; and planning, design, or construction of roadways within former interstate or highway rights-of-way.

Other Provisions

Under the Congestion Mitigation and Air Quality

(CMAQ) program, flexible funding will be available for transportation projects and programs geared toward meeting the requirements of the Clean Air Act, with particular attention to areas that are in nonattainment for fine particulate matter ($PM_{2.5}$). These funds can be used for diesel retrofit of construction equipment, which may permit contractors with older equipment to work in such areas. The CMAQ program will also provide funding to reduce congestion and improve air quality for areas that do not meet the National Ambient Air Quality Standards for ozone, carbon monoxide, or particulate matter (nonattainment areas) as well as former nonattainment areas (maintenance areas).

In addition, MAP-21 authorizes $400 million per year for highway research development, technology deployment, training and education, intelligent transportation systems, university research, and transportation statistics.

Finally, the law permits states to bid projects using a Construction Management General Contracting scheme, which uses a two-step procurement process to select a CM/GC using both price and best value.

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Conclusion

It is no secret that the United States suffers from inadequate and failing infrastructure. During the current economic decline, MAP-21 avoided the worst-case scenario of significant cutbacks in investment for construction and maintenance of infrastructure. However, MAP-21 does not increase funding levels beyond modest inflation adjustment and its short duration of 27 months does not provide a long-term, sustainable solution that assures adequate funding for our nation's surface transportation programs. Ultimately, a long-term funding authorization is required.

Illinois Legislation Confirms Construction Lien Priority Overriding Illinois Supreme Court

Changes to Illinois's Mechanics Lien Act effective February 2013 confirm that construction liens hold priority over all encumbrances filed after entry into the construction contract. These changes follow shortly after a controversial decision by the Illinois Supreme Court interpreting the language of the prior Mechanics Lien Act to subordinate construction liens to construction lenders for the portion of improvements advanced by the construction loan, *LaSalle Bank N.A. v. Cypress Creek I, LP*, 242 Ill. 2d 231, 950 N.E.2d 1109 (2011). The language of the original statute defined the priority of construction liens relative to other encumbrances as follows:

> No incumbrance [*sic*] upon land, created before or after the making of the contract under the provisions of this act, shall operate upon the building erected, or materials furnished until a lien in favor of the persons having done work or furnished material shall have been satisfied, and upon questions arising between incumbrancers and lien creditors, all previous incumbrances shall be preferred to the extent of the value of the land at the time of making of the contract, and the lien creditor shall be preferred to the value of the improvements erected on said premises, and the court shall ascertain by jury or otherwise, as the case may require, what proportion of the proceeds of any sale shall be paid to the several parties in interest. [770 Ill. Comp. Stat. 60/16 (2012).]

Prior interpretations of this statute determined that in order to calculate the foreclosure proceeds available to construction lien claimants, a court would compare the value of the property at the time of making the contract with the value of subsequent improvements to the project. The lender was assigned the proportionate share equal to the original value of the property and the lien claimants would receive the proportionate share equal to the value of the improvements. What the Illinois Supreme Court in *Cypress Creek* addressed was how this calculus operated when the foreclosure sale resulted in an amount substantially less than the original value of the property and the construction lender had funded project improvements. Would the lien claimants or the lender get the benefit of the portion of the improvements that were actually paid for during the project?

In answering this question, the Illinois Supreme Court interpreted the Mechanics Lien Act to find that construction lien creditors held priority with respect to the proportionate value of only the lien claimants' improvements. The court's decision went further, holding that the construction lender's mortgage, and not the lienholders, held priority with respect to the value attributable to all improvements paid with lender advances. As a result, the court expanded the calculation of priority by dividing the proceeds attributable to project improvements with the mortgage lender being allocated the proportionate share equal to the improvements it funded. The lien claimants would be allocated the portion attributable to their unpaid improvements. Because the unpaid contractor's lien claims were low in comparison to total improvements to the project, the *Cypress Creek* decision resulted in the lien claimants receiving only a small fraction of their total claims and the lender taking priority with respect to the more significant paid-for project improvements.

Controversy followed the *Cypress Creek* decision.

Many, especially contractors and suppliers, felt that the court had shifted priority and subordinated construction liens to construction mortgages without statutory direction and in the face of a statutory grant of priority with respect to the "value of the improvements erected." The Illinois legislature responded, modifying the original language of the statute and adopting additional language that confirmed the intent to grant lien claimants priority with respect to all project improvements, regardless of whether a portion was paid for by the lender. In particular, the statutory revisions added the following language to the Mechanics Lien Act:

> When the proceeds of a sale are insufficient to satisfy the claims of both incumbrancers and lien creditors, the proceeds of the sale shall be distributed as follows: (i) any previous incumbrancers shall have a paramount lien in the portion of the proceeds attributable to the value of the land at the time of making of the contract for improvements; and (ii) any lien creditors shall have a paramount lien in the portion of the proceeds attributable to the value of all subsequent improvements made to the property. [770 Ill. Comp. Stat. 60/16 (2013).]

Under this new language, contractors and others responsible for improving a project will receive the benefit of priority with respect to all improvements to a project, regardless of whether payment was through advances by the construction lender.

The issues confronted by the Illinois legislature in response to the court's interpretation in *Cypress Creek* are not unique but characteristic of the enduring struggle between interests of construction lien claimants and those lending proceeds for construction. Courts and state legislatures throughout the country are faced with similar challenges when providing construction lien rights that are fair to contractors and other project participants whose works improve real estate, without unfairly impacting the lending and investment necessary for project development in the first place. In recent years, the balance of parties' rights has had renewed interest as limited resources and declining property values have emphasized the significance that statutory lien priority can have when a project fails.

Designation of Lien Agent Is Focus of North Carolina Lien Law

North Carolina adopted numerous changes to its lien laws effective in early 2013. These include changes that prevent a general contractor's lien waiver from affecting subcontractor lien rights, requirements for the service of claims for liens on "upstream" parties, and changes to standard lien forms. The most notable change, however, was the adoption of the requirement that owners must designate a "lien agent" for all private projects exceeding $30,000 in total improvements (except for single-family owner-occupied residences). The lien agent must be a title insurance company or title agent selected from the list of registered lien agents maintained by the state's Department of Insurance.

The lien agent must be designated no later than when the owner first contracts with any person to improve the property. Notice by the owner to the project participants of the identity of the lien agent is to be accomplished in a variety of ways depending on the circumstances, but in most cases the lien agent will be identified on the building permit that is required to be posted at the project site. Contractors, in turn, are obligated to provide notice of the identity of the lien agent to lower-tier subcontractors that are not required to furnish labor at the project site and, therefore, would not be able to view the posted building permit. A contractor's failure to provide this notice within three business days of contracting with the lower-tier subcontractor subjects the contractor to liability for damages incurred by that subcontractor by reason of having not received such notice.

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The lien agent's intended role is to maintain a list of parties that provided work or materials for improvement of the project, and thereby protect the owner and the title insurer from liens by unknown parties. Those project participants that wish to preserve their lien rights must serve the lien agent within 15 days after furnishing their first labor or materials for the project with a notice identifying the participant as a potential lien claimant. While a contractor's notice to the lien agent may be a minor procedural hurdle at the beginning of a project, architects may have a more challenging time adapting to the new law, because the architect is typically brought on in the very early stages of project development. There is an exception to notice where the architect starts work before the owner designates the lien agent; however, those architects brought on after a lien agent is already designated but before a building permit is issued will be responsible for inquiring as to the identity of the lien agent and serving notice. Because the architect may have no way of knowing at the time of contracting whether the owner has already designated the lien agent, a formal inquiry may be necessary for all projects.

Failure by a lien claimant to provide notice to the lien agent may result in an outright termination of lien rights or a subordination of the lien to the rights of new owners or lenders upon sale or conveyance of the property.

A lien claimant that provides notice either within the 15-day window or, if late, prior to the recording of any mortgage or deed of trust for the property will retain its right to a lien superior to all other mortgages against the property, provided all other statutory lien procedures are met.

The concept of a lien agent is not an entirely new concept and the statutory changes adopted by North Carolina were likely modeled after Virginia's requirements for lien agents on residential projects. The law's requirement for the appointment of a new party, the lien agent, however, is representative of the varied and sometimes unique approaches taken among the states in order to address uncertainty posed by unknown lien claimants. As the changes in North Carolina appear to be the result of extensive lobbying by the title insurance industry, they are indicative of the attention title insurers are paying to the risks posed by lower-tier and other unknown lien claimants. Although North Carolina's lien priority structure has not changed with this recent legislation, the additional protection and certainty afforded to owners and title insurers appear as a significant compromise in favor of maintaining the superiority of construction liens.

Endnotes

1. Press Release, John L. Mica, Chair, Transp. & Infrastructure Comm., *House Approves Major Transportation Reform Bill* (June 29, 2012), http://archives.republicans.transportation.house.gov/news/PRArticle.aspx?NewsID=1664.
2. *Moving Ahead for Progress in the 21st Century Act (MAP-21)*, U.S. Dep't of Transp., http://www.dot.gov/map21 (last visited May 2, 2013).
3. Press Release, Congressman John J. Duncan Jr., *Duncan Praises Highway Bill Deal* (June 27, 2012), http://duncan.house.gov/press-release/duncan-praises-highway-bill-deal.
4. Mica Press Release, *supra* note 1.
5. Duncan Press Release, *supra* note 3.

