

## What Vermont's Lien Law Means for Lenders; and for Contractors and Sub-Contractors

By David W. M. Conard <sup>1</sup> and Erin Miller Heins <sup>2</sup>

### Introduction

All state mechanics' lien laws strike a balance among the rights of owners, contractors, sub-contractors and lenders. Vermont's statutory scheme is relatively protective of the rights of owners and lenders.

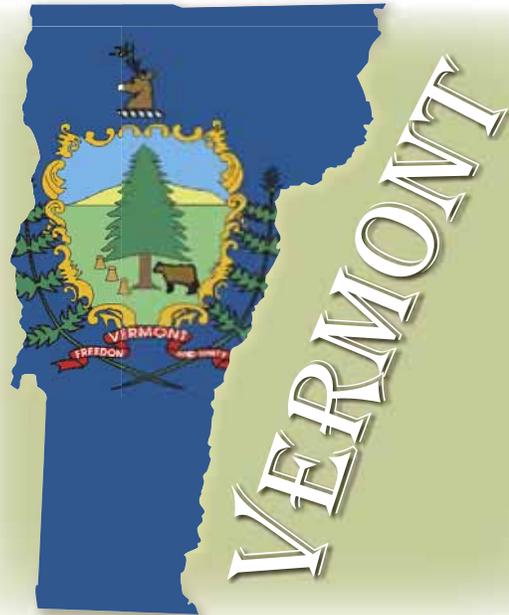
### The Basics of Vermont's Mechanics' Lien Law

Vermont's mechanics' lien law, codified at 9 V.S.A. § 1921 *et seq.*, provides a lien in favor of contractors, sub-contractors and materialmen who supply labor and materials for the construction of improvements to real property.<sup>3</sup> Vermont law does not differentiate between commercial and residential projects, but does provide for different procedures depending upon whether the party claiming the lien has a direct contract with the owner, or a contract with an agent, contractor or sub-contractor of the owner. Regardless of whether the lien claimant has a direct contract with the owner, or only with an agent of the owner, the lien is inchoate (i.e. not yet complete or fully developed) until the statutory requirements are complied with.

#### a. Notice of Lien

The inchoate lien ceases to be of any effect unless a written notice of lien is delivered to the owner and recorded in a timely fashion in the land records of the municipality where the property is located.<sup>4</sup> In order to preserve the lien, the notice must be recorded within 180 days from the time when payment last became due for labor performed or materials furnished by the claimant.<sup>5</sup> Although the statute requires only a written memorandum, signed by the claimant, it is customary

*continued on page 2*



### In this issue:

- **What Vermont Lien Law Means for Lenders; and for Contractors and Sub-Contractors**
- **SBA Risk Based Reviews**
- **Real Estate Outlook: Signs of Recovery**
- **CMBS Special Servicers Get Creative as Volume Increases**
- **Builder Confidence at Highest Rate in Two Years**

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<sup>3</sup>VT. STAT. ANN. tit. 9 § 1921.

<sup>4</sup>*Haigh Lumber Co. v. Drinkwine*, 130 Vt. 120, 287 A.2d 560 (1972).

<sup>5</sup>VT. STAT. ANN. tit. 9 § 1921.



David Conard



Erin Miller

## Vermont's Lien Law

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practice to identify the real estate encumbered by the lien (by reference to land records recording data if possible), to state the unpaid contract balance for which the lien is claimed, and to state that fewer than 180 days have elapsed since payment became due for the last labor performed or materials supplied.

### b. Perfection of Lien by Attachment

Just as the lien becomes invalid if notice is not recorded in the land records within 180 days, the lien also becomes invalid if the claimant does not commence suit and obtain an attachment from a court of competent jurisdiction within 180 days from the date of recording, or 180 days from the date when payment becomes due, whichever is later.<sup>6</sup> It is important to note that the claimant must actually obtain an attachment within the 180 day period; it is not enough that the claimant simply file suit.<sup>7</sup> Unless a claimant can satisfy the standard for obtaining an Order of Approval *ex parte*, the required Order of Approval of attachment may only be issued upon a motion, after five days notice to the defendant, unless the judge proscribes a shorter notice period for good cause.<sup>8</sup> The legal standard for obtaining an attachment is a court finding of a reasonable likelihood the claimant will recover judgment, including interest and costs, in an amount equal to or greater than the amount of the attachment sought, over and above any liability insurance, bond, or other security shown by defendant to be available to satisfy the judgment.<sup>9</sup> The motion for writ of attachment must be accompanied by an affidavit setting forth facts which are sufficient to establish the factual requirements for the attachment.<sup>10</sup> Because of the factual findings necessary for the court to issue an attachment perfecting a contractor's lien, the existence of a bond will defeat the lien, and an owner's claim of set off can defeat or reduce the amount of the lien. Once obtained, the Court's Order of Approval of the attachment must be served upon the owner and should be delivered to the sheriff or other officer for service on the municipal clerk for recording in the land records.<sup>11</sup>

<sup>6</sup>VT. STAT. ANN. tit. 9 § 1924.

<sup>7</sup>*Filter Equipment Co. Inc. v. International Bus. Mach. Corp.*, 142 Vt. 499, 502, 458 A.2d 1091, 1092 (1983); *Piper v. Hoyt*, 61 Vt. 539, 17 A.798 (1889).

<sup>8</sup>VT. R. Civ. P. 4.1.

<sup>9</sup>Id.

<sup>10</sup>Id.

<sup>11</sup>VT. R. Civ. P. 4.1.

<sup>12</sup>VT. STAT. ANN. tit. 9 § 1925.

### c. Foreclosure of Liens

A lien claimant who successfully prosecutes an action to judgment must record a certified copy of the judgment in the land records within five months of the date of issuance of the judgment, and thereafter may foreclose the lien in the same manner as a mortgage is foreclosed.<sup>12</sup> As with other deadlines in the statute, a lien claimant should assume time deadlines will be strictly construed. The fact that the judgment may be on appeal has been held not to toll the five month deadline.<sup>13</sup> It should be noted that Vermont is a "strict foreclosure" jurisdiction, meaning a foreclosing creditor does not necessarily have to pay any excess equity to the property owner, but may in most circumstances take title to the property, subject to any liens having priority over the lien being foreclosed.<sup>14</sup>

### d. Priority of Liens

If the statutory requirements are adhered to, the priority date of the lien will relate back to the date of the visible commencement of work on, or delivery of material to, the property being improved.<sup>15</sup> The Bankruptcy Court in the District of Vermont has held that under Vermont law, the lien priority is afforded to the full amount of an eventual judgment, even if it exceeds the face amount of the lien, and this decision has been affirmed by the Second Circuit.<sup>16</sup> However, a contractor's lien does not have priority over a conveyance or mortgage to the extent that consideration is given in good faith for that conveyance or mortgage before the notice of lien is recorded in the land records.<sup>17</sup> Furthermore, advances made by a mortgagee after receiving notice of a claim of lien will have priority over the contractor's lien if the mortgagee can show that the funds subsequently advanced were actually expended for improvements to the property.<sup>18</sup>

Although the priority date of the lien is the visible

*continued on page 3*

<sup>13</sup>*In re Cusson*, 412 B.R. 646 (D.Vt. 2009).

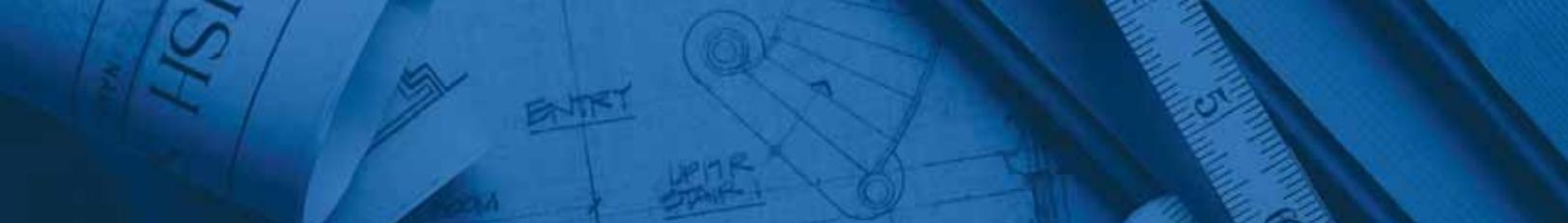
<sup>14</sup>V. R. Civ. P. 80.1.

<sup>15</sup>VT. STAT. ANN. tit. 9 § 1923.

<sup>16</sup>*In re Rainbow Trust*, 216 B.R. 77 (2d Cir. BAP Vt. 1997).

<sup>17</sup>VT. STAT. ANN. tit. 9 § 1921(d).

<sup>18</sup>Id., *Haight Lumber Co. v. Drinkwine*, 130 Vt. 120, 287, A.2d 560 (1972).



## Vermont's Lien Law

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commencement of work, the value of the claimed lien as of this priority date is subject to reduction by certain subsequent events. Importantly, if the lien claimant is one that does not have a direct contractual relationship with the owner (such as a subcontractor) the claimant's lien is limited to the amount of money owed by the owner to the prime contractor as of the date that the owner receives notice of the indirect claimant's lien.<sup>19</sup>

### Lender Protections

As noted above, if a lender records a mortgage which is taken in exchange for value (i.e. the lender actually advances mortgage loan proceeds) in good faith, prior to the date a notice of lien is recorded in the land records, the lender's mortgage will have priority over the contractor's lien, regardless of whether the lien claimant is in direct privity with the owner.<sup>20</sup> Furthermore, the statute provides a mechanism for the lender to make future advances that are not subordinate to the contractor's lien. If the mortgage secures a construction loan which is not fully advanced at the time the lender receives notice of the contractor's lien, future advances under that construction loan will still have priority over the contractor's lien provided the lender can show the advances were actually expended in constructing improvements to the real property to which the lien attaches.<sup>21</sup>

### Policy Considerations

When enacting contractor's lien statutes, legislatures make policy decisions about who gets the short straw when a contractor, sub-contractor or materialman does not get paid. The Vermont statutes described above, allows owners and lenders to protect themselves at the expense of sub-contractors and materialmen, and most often at the expense of the prime contractor. For example, if a sub-contractor records a notice of lien, and delivers a copy of such notice to the owner, after the owner has paid the prime contractor in full, there is no value on which the sub-contractor's lien attaches.<sup>22</sup> If the owner receives such notice when money is still owed to the prime contractor (even if unrelated to the work performed by the lien claimant) the owner will withhold further

payments on the prime contract until the lien claim is resolved. This can obviously put tremendous financial pressure on the prime contractor. For example, if a painting sub-contractor has botched the job, and the prime contractor has withheld payment and fired the painter, the prime contractor may bring in a replacement painter who does a fine job and gets paid by the contractor. If the original painter records a notice of lien at a time when the owner still owes money to the prime contractor (perhaps for final landscaping or retainage) payments to the prime contractor are likely to stop while he deals with what may be a frivolous claim by the fired painter.

### Conclusion

Vermont's Lien Law affords significant protections to owners and lenders at the expense of sub-contractors and materialmen, and most often at the expense of the prime contractor. It is particularly easy for a diligent lender to protect itself under the Vermont statutory scheme provided the lender understands and adheres to the statutory framework. Even if construction has commenced before a construction loan is put in place, the lender simply needs to insure no lien claimants have recorded a notice of lien in the land records at the time the mortgage is recorded. Should the lender receive notice of a lien claim before all loan funds are fully advanced, the lender can use some combination of project oversight and joint checks to ensure advances are limited to improving the mortgaged property. By implementing and strictly adhering to a defined set of procedures, the lender can preserve the complete priority of its mortgage.

### Construction-at-a-Glance

	April 09	April 10
Total Monthly Housing Starts*	477	672
One Unit	386	593
Multifamily	91	79
YTD Permits-Single Family*	395	484
YTD Permits-Multifamily*	128	122
Monthly New Home Sales*	341	504
Unemployment Rate	8.9%	9.9%

\*Thousands of Units

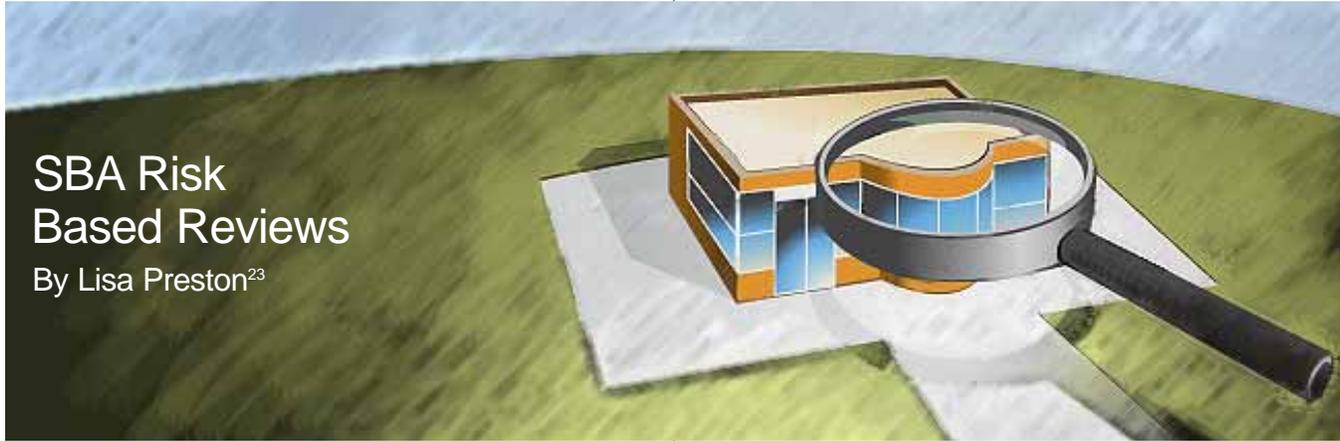
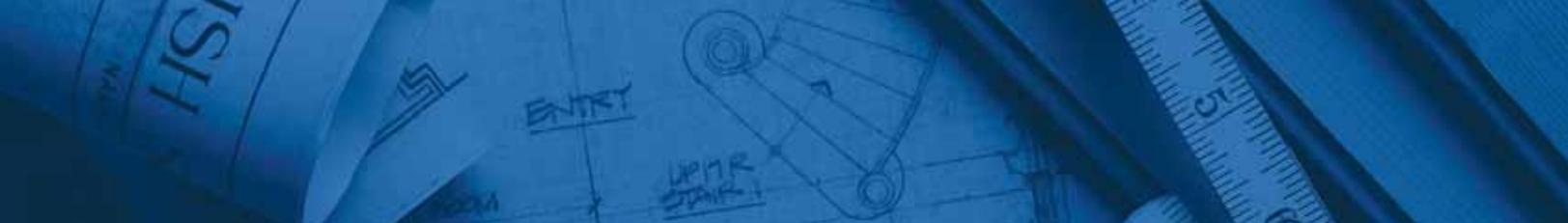
Source: U.S. Bureau of the Census, Construction Reports, Series C-20, Housing Starts. U.S. Bureau of Labor Statistics.

<sup>19</sup>Newport Sand and Gravel Co. v. Miller Concrete Construction, Inc., 159 Vt. 66, 614 A.2d 395 (1992).

<sup>20</sup>VT. STAT. ANN. tit. 9 § 1921(d).

<sup>21</sup>Id., Haigh Lumber Co. v. Drinkwine, 130 Vt. 120, 287, A.2d 560 (1972).

<sup>22</sup>King v. Hoadley, 112 Vt. 394, 26 A.2d 103 (1942).



## SBA Risk Based Reviews

By Lisa Preston<sup>23</sup>

If you have an SBA portfolio and it continues to grow in size, most likely at some point, you will be subject to an SBA Risk Based Review. The Office of Credit Risk Management (OCRM) is the division of SBA who monitors the loan portfolios and is responsible for the on-site review process for the 7(a) and 504 loan programs. On-site reviews occur at least every 24 months for 7(a) lenders with a portfolio size exceeding \$10 million and 504 certified development companies with a portfolio size exceeding \$30 million.

The on-site SBA Risk Based Review includes not only loan review but also process review. The SBA is reviewing the overall SBA operation and making an assessment of four key components. They are Portfolio Performance, Management & Operations, Credit Administration, and Compliance. Let's discuss each component in further detail.

Portfolio Performance is exactly what you would think it is. SBA is looking at the performance of your SBA loan portfolio as it compares to the SBA portfolio averages and as it compares to your specific peer group. The overall portfolio is given an SBA Risk Rating. In addition, the SBA has a Lender Portal accessible by all lenders and CDC's. Once you obtain a login and password, your portfolio performance rates such as delinquency, past due, etc. are at your fingertips. SBA also provides you with the Small Business Predictive Score (SBPS) which predicts the probability of each loan in your portfolio going into default. The SBA Lender Portal is an excellent tool to monitor what is happening in your portfolio and has consistently been updated quarterly by the SBA in the past. Here recently, the data has not been updated on a consistent basis due to revisions of the system. SBA

expects to be back on track with quarterly updates very soon.

Early default is another area SBA consistently monitors to determine if a pattern or trend is developing within the loan portfolio. Guaranty purchases and debenture repurchases are reviewed to ensure any trends developing are addressed immediately. Industry and geographical concentrations are also reviewed to ensure proper diversification of risk.

Management & Operations is again exactly what you think it is. SBA is reviewing your overall SBA operations and assessing whether management is involved in the day to day details or if they are nonexistent. A review of the structure of management including the Board of Directors and all committees is performed. The internal operating plan of management is also reviewed to determine if it is adequate for the size of the operation and to ascertain whether goals are attainable. If an SBA Credit Policy Manual exists, actual policies and procedures are reviewed to determine if they adequately follow the manual and are in conformity with the Code of Federal Regulations (CFR) and the SBA's Standard Operating Procedures (SOP's). Internal and external controls are also reviewed as they are always an important aspect of any management and operational structure.

The Credit Administration component consists of a review of all procedures associated with an SBA loan commencing with the application phase and concluding with the liquidation phase, if applicable. Therefore, application, underwriting, processing, closing, servicing, intensive servicing, collections, and liquidation areas are all reviewed in detail. The SBA is looking to ensure all borrowers are creditworthy small businesses with sufficient management experience to succeed in the stated endeavor, whether an existing or new business.

<sup>23</sup>Lisa Preston is President of The Preston Group, a financial consulting company specializing in SBA compliance issues for both 7(a) and 504 loan programs. Formerly working for the FDIC during the banking crisis of the 1980's and more recently on behalf of the SBA, Ms. Preston has over 25 years of experience in all facets of commercial, residential, acquisition & development, construction, and government guaranteed loans. Ms. Preston may be contacted at 281.557.3435 or via e-mail at lpreston@the-preston-group.com.

*continued on page 5*

## SBA Risk Based Reviews

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Pre closing and post closing check and balances are reviewed to determine if adequate internal controls exist. The internal risk rating system is also monitored to determine if it is assessing risk appropriately. If loan agents or brokers are used in the application process, a thorough review of the entities and their involvement including underwriting is assessed to determine if a pattern or trend has occurred with past dues, delinquencies or liquidations. Loan sales are also reviewed to determine if compliant with SBA requirements.

The Compliance component review encompasses borrower eligibility and reporting requirements. All areas of borrower eligibility such as, credit not available elsewhere, personal resources test, size determination, no prior loss to the federal government and EPC/OC requirements, to name just a few, are reviewed when conducting loan review to ascertain compliance with all SBA mandates. Required reporting to SBA is also reviewed for completeness, accuracy, and timeliness.

The SBA Risk Based Review culminates with a written report documenting the review in detail and outlining any deficiencies noted. Any patterns or trends noted during the on-site review in both process and loan review will be stipulated as findings in the written report. The report is usually received within 60 days of the actual on-site review.

Common pitfalls for construction lenders can be found in several areas of the loan process. One area where issues can occur is the proper documentation

of borrower injection for 7(a) lenders and borrower contribution for 504 CDC's. If borrower injection or borrower contribution is a requirement in the Loan Authorization, properly documenting the injection or contribution is absolutely necessary in order to meet SBA's requirements. Documentation in the borrower injection or contribution area can never be too much!

Site Visits are also a very important part of construction lending. Adequately monitoring construction performance, the job site, costs, disbursements, and construction timeframes are integral to successful completion of a project. Keeping the borrower, general contractor, sub-contractors, lender, and sometimes a CDC happy while eliminating any mechanics and materialmen's liens, is not an easy feat. Site visits are also required at various intervals of default, liquidation, and during some borrower servicing requests. Dollars spent in this area to ensure compliance with SBA requirements is money well spent. Again, documentation in this area can never be too much!

SBA wants to know the whole story intricately on each and every borrower when conducting the SBA Risk Based Review. This applies to a current, past due, delinquent, or liquidation loan. The only way to ensure SBA has the full story and accurately assesses your compliance is to properly document all loan files.

The most basic and the most advanced rules to follow in SBA are: Document and Document. Prudent lending actions can be justified to SBA with proper documentation.



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## Real Estate Outlook: Signs of Recovery

by Kenneth R. Harney<sup>24</sup>

If you've been waiting for rock-solid statistical evidence that the housing market – and the national economy – are well along into recovery mode, you definitely got it last week.

Sales of existing single family homes jumped by 7.3 percent in March, according to the National Association of Realtors survey released last Thursday, and were 13 percent above year-earlier levels.

Median home prices were up as well, despite the heavy presence of foreclosures and short sales being pumped into the listing inventory. Median single family prices were up by 9 percent year over year in the Northeast region, and by about 7 percent in the South, Midwest and the West.

Meanwhile, unsold inventory dropped by two percent in March, and is now 22 percent below its peak in July 2008.

Lawrence Yun, chief economist of the National Association of Realtors, said the recovery is now “broad” and unmistakable “in nearly every part of the country,” thanks in part to improvements in the national economic outlook and the spur to sales being exerted by the expiring housing tax credits.

Home builders are clearly getting the upbeat message about the recovery as well. March single family housing starts rose by 1.6 percent to their highest level since November of 2008.

New permits – a gauge of where builders expect market demand to be six months or more down the road – were up by seven and a half percent for the

month, and are 34 percent higher than they were in March 2009 - the biggest year over year gain in permits since 1992!

The latest weekly measure of new home purchase loan applications, compiled by the Mortgage Bankers Association, jumped by 10 percent – which is attributable in part to the April 30 contract deadline for the \$8,000 and \$6,500 federal tax credits.

Consumer confidence and expectations about the national economy also are on the upswing, up by 6 points last month, according to the Conference Board. The board's widely watched index of leading economic indicators registered a gain of 1.4 percent for the month.

Fannie Mae's economics department issued its forecast for the balance of the year last week – and the tone was moderately optimistic. Fannie projects national economic growth - as measured by the gross domestic product or GDP - to gain about 3.1 percent this year.

That won't be enough to make a major dent in the jobless rate, said the economists, but it should reflect a slow but steady improvement in key employment sectors, including manufacturing.

Bottom line this week: Think positive. Because that's where we're headed in real estate and the economy overall.

“Bottom line this week: Think positive. Because that's where we're headed in real estate and the economy overall.”

<sup>24</sup>Kenneth R. Harney writes an award-winning, nationally-syndicated column on housing and real estate from Washington, D.C. He is also managing director of the National Real Estate Development Center, a professional education company. He is a past member of the Federal Reserve Board's Consumer Advisory Council, a committee that by federal statute reviews all Fed actions on home mortgage, consumer credit and banking industry regulation.

He served as a member of the U.S. Department of Housing and Urban Development's Working Group on Computerized Loan Origination (CLO) systems, and is a member of the Editorial Board of the Fannie Mae Foundation's journal, Housing Policy Debate. He is the author of two books on mortgage finance and real estate.

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## CMBS Special Servicers Get Creative as Volume Increases

by Michael Murray<sup>25</sup>

Commercial mortgage-backed securities special servicers turned to creative workout strategies when volume reached \$81.7 billion at the end of the first quarter, said Fitch Ratings, New York.

Nearly 5,000 loans in special servicing rapidly increased workload and staff.

“Special servicers are now engaging in bulk note sales, modifications into A/B notes and forbearance,” said Stephanie Petosa, managing director at Fitch. “However, the majority of the loan workouts remain within the more traditional realm of extensions, modifications and foreclosures.”

Fitch said it expects to complete annual ratings reviews on four of five most active special servicers by the end of this month, and the ratings agency plans to provide a more in-depth overview of current and emerging CMBS special servicing trends in its quarterly report later this month.

In April, CMBS delinquencies increased 89 basis points and loans 30 or more days delinquent, in foreclosure or real estate owned increased 41 basis points to put the overall delinquency rate at 8.02 percent, said Trepp LLC, New York.

With more than \$798 billion in unpaid CMBS balances within the United States in March, nearly \$49 billion of U.S. CMBS loans are either delinquent 90 days or longer, in foreclosure or real estate owned properties, said Realpoint LLC, Horsham, Pa.

Standard & Poor’s, New York, said loan transfers to special servicers eased somewhat at the end of last year and fell 4 percent while dollar volume dropped 19.5 percent. However, S&P also said it believes the large-balance retail loans that entered special servicing earlier in 2009 as a result of General Growth Properties’ April 2009 bankruptcy filing may have skewed the comparison.

However, Fitch said large loans drove newly defaulted loans to 487 at an \$8.43 billion volume in the first quarter.

“Large loans defaults will continue to escalate, with the majority coming from recent vintage CMBS,” said Mary MacNeill, managing director at Fitch.

Upcoming maturities and other imminent or nonmonetary defaults--rather than actual missed payments--continued to account for nearly 60 percent of all transfer activity by loan count in the second half of 2009 to special servicing, S&P said.

MacNeill, however, said “limited demand for office space brought on by high unemployment will lead to an uptick in defaults.”

The United States is not the only country with distressed commercial property and CMBS concerns. The Financial Times said commercial property loan defaults increased to more than \$31.7 billion in the United Kingdom last year while \$4.3 billion defaulted in 2008, based on DuMonfort University’s Commercial Property Report in the U.K. For 2009.

DuMonfort reported a record \$71.7 billion of bank loans against commercial properties in the United Kingdom are in trouble, following a sharp slump in real estate values from their peak.

More than 70 percent of outstanding bank debt – nearly \$232.3 billion – is due for repayment in the next five years, DuMonfort said, and \$24.5 billion more in securitized debt sold to investors is due to expire during that time in the U.K.

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## Builder Confidence at Highest Rate in Two Years

by Mike Sorohan<sup>26</sup>

After months—many months—of dismal news for home builders, new data suggest hope for recovery.

The National Association of Home Builders yesterday reported that builder confidence in the market for newly built, single-family homes rose for a second consecutive month in May to its highest level in more than two years. The NAHB/Wells Fargo Housing Market Index gained three points to 22 in May, its highest point since August 2007.

The numbers remain subdued in historical context; an index figure under 50 indicates that home builders are more pessimistic about their short-term prospects. But 22 sounds much better than 9, which is where the Index bottomed out last year.

“Sales expectations for the next six months continued to gain, despite the expiration of the home buyer tax credits at the end of April,” said NAHB Chief Economist David Crowe. “This means builders are more comfortable that the market is truly beginning to recover, and that positive factors for buying a new home—low interest rates, great selection, stabilizing prices and a recovering job market—are taking the place of tax incentives to generate buyer demand.”

The Index gauges builder perceptions of current single-family home sales and sales expectations for the next six months as “good,” “fair” or “poor.” The survey also asks builders to rate traffic of prospective buyers as “high to very high,” “average” or “low to very low.” Scores for each component are then used to calculate a seasonally adjusted index where any number over 50 indicates that more builders view sales conditions as good than poor.

Each of the Index’s three component indexes posted three-point gains in May. The component gauging current sales conditions climbed to 23, its highest level since July 2007. The component gauging sales expectations in the next six months rose to 28, its highest point since November 2009; the component gauging traffic of prospective buyers improved to 16, its best showing since September 2009.

Every region gained in May. The Northeast, which has the smallest survey sample and is therefore subject to greater month-to-month volatility, rose 14

points to 35, its highest point since June of 2007. The Midwest posted a two-point gain to 17, while the South registered a one-point gain to 22 and the West posted a seven-point gain to 20.

Crowe noted that builders still face numerous obstacles to a full recovery. “It’s worth repeating that continued challenges such as the critical lack of project financing, inappropriate appraisal procedures, competition from short sales and foreclosures and the soaring costs of some building materials are major obstacles on the path to a healthier housing market and economy,” he said.

### UPCOMING EVENTS

#### Please Visit Us at These Upcoming Events:

##### Mid-America Lenders Conference (MALC)

August 17-19, 2010  
New Orleans Marriott  
New Orleans, LA

##### National Association of Development Companies – 2010 Regions 8, 9 & 10

October 10-13, 2010  
Waikoloa Beach Marriott Resort & Spa  
Kona, HI

##### Risk Management Association (RMA) Annual Risk Management Conference

October 17-19, 2010  
Baltimore Marriott Waterfront  
Baltimore, MD

##### National Association of Government Guaranteed Lenders (NAGGL) Annual Conference

October 26-28, 2010  
Disneyland Hotel  
Anaheim, CA

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### **2010 Call Schedule:**

Mid-July date to be determined. Contact NACL for more information.

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