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STAY UP-TO-DATE

Stay up-to-date through *This Week* and our legislative update calls during session. TBA also invites member banks' in-house counsel to join our Bank Lawyers Committee. Contact Amy Heaslet to learn more at ahaslet@TNBankers.org.

The battle over lien priority between lenders and construction contractors

Banks are the economic engines that fuel their communities and industries within them. Yet one particular issue proposed in the legislature this year threatens that by potentially destabilizing Tennessee's construction industry.

The legislation stems from an issue raised last year from the American Subcontractors Association of Tennessee that was intended to address delayed payment issues their members were experiencing on construction projects. As originally proposed, it would have directly addressed the issue by prohibiting general contractors from including provisions in their contracts with subcontractors that they would not have to pay subcontractors until they received payment from the developer.

The proposal was not warmly received by the groups representing general contractors and the discussions on appropriate solutions carried over throughout the summer. The groups eventually agreed to a more comprehensive re-write of the construction and lien laws, and in October, they presented their proposal to all interested parties.

At the core of their proposed compromise was an attempt to "share the risk" between contractors and lenders by removing lenders' lien priority. As drafted, in the event of foreclosure, lenders would recover only their pro rata share of the foreclosure sale proceeds with the rest going to contractors. It would also remove lenders' exemption from the Prompt Pay Act, which means contractors could go directly to lenders for payment if an owner does not timely pay them.

In a series of meetings we had with the construction coalition pushing these proposals, we explained repeatedly that injecting a "share the risk" approach in construction projects would not only burden lenders but could potentially cause them to cease lending on construction projects altogether.

Despite explaining this potential outcome to the construction coalition, the coalition persisted.

As session started, we spoke with the sponsors of the legislation and were asked to compromise on any points possible in order to move forward with the measure. After reaching out to our bankers for their approval, we agreed to one point. Banks, when serving as the owner or developer of a project, would set up retainage accounts as required of every other owner. For those unfamiliar with construction law, retainage accounts are essentially an escrow account where the project owner sets aside 5% of the cost to serve as an incentive for the contractors to complete the project. Banks are currently exempt from having to set them up if they serve as owner/developer of a project.

We made it adamantly clear that although we will agree to this, in no form or fashion would we ever agree to forego lenders' lien priority or allow contractors to go directly to lenders for payment if an owner does not pay timely.

Fortunately, the Senate sponsor, Jack Johnson (R-Franklin), understood the role banks play in construction lending and the negative impact the contractors' proposal could have—not just on lenders but on the entire construction industry. Senator Johnson agreed to move forward with their legislation but without the provisions calling for lien parity and requiring lenders to make direct payments to contractors in the event owners do not pay.

That was a huge win for TBA and the banking industry, and our bankers were the driving force behind it. Your responses and explanations made it clear to us and legislators how critical it was to stop these efforts. We appreciate your feedback and outreach on this critical issue 🇺🇸