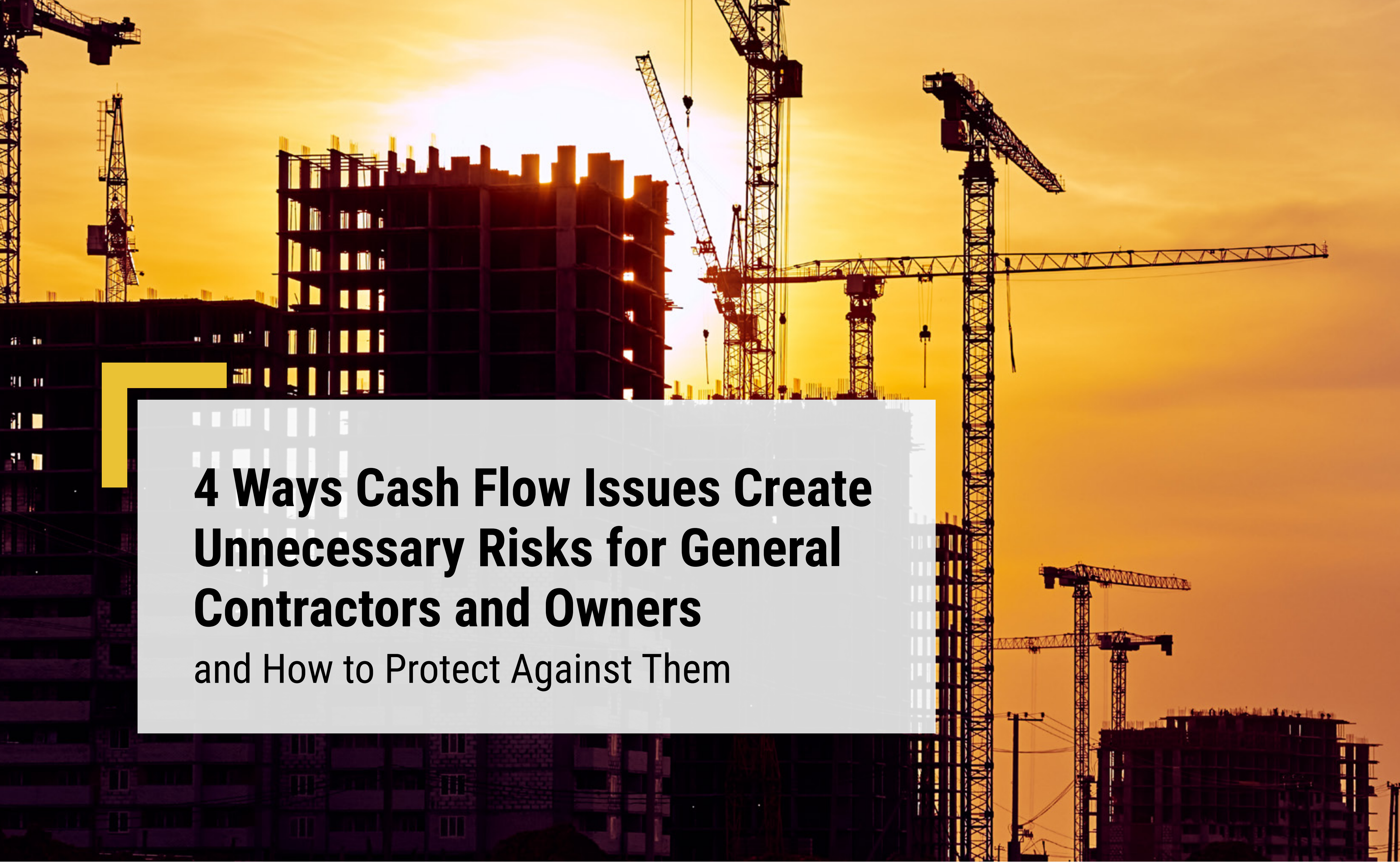

4 Ways Cash Flow Issues Create Unnecessary Risks for General Contractors and Owners

and How to Protect Against Them

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Most subs are in a cash flow crisis. Cash-management, funds control and risk-mitigation companies eliminate the problem — and provide a project safety net at no cost to general contractors and owners. Here's why it works.

In 2017, John Bianchi's still-fledgling engineering, procurement and construction company, Amps Electric Inc., was at a crossroads. The company had just finished a major project but was having trouble securing full payment. Meanwhile, opportunity presented itself: two new projects that would require a fast buildup of employees — and significant funding.

How could the company handle such a large undertaking?

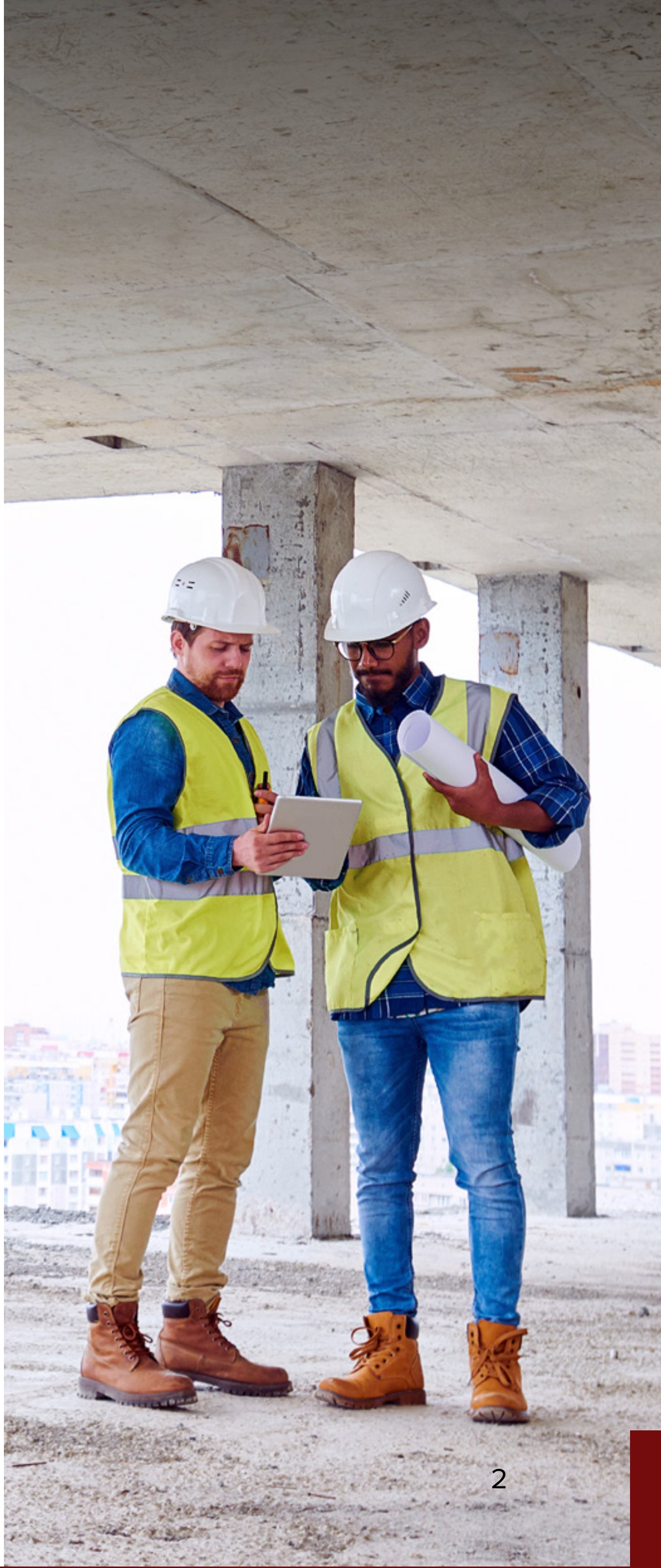
The answer came in the form of a little-known and poorly understood funding option: a cash-management, funds control and risk-mitigation company that provided Bianchi with the funds to cover payroll and take on the additional work.

"We could have never done it without them," said Bianchi, CEO of Amps Electric. "I don't know if we'd even be around if not for them."

And thanks to the financial management the company offered, it also helped springboard Amps to a new level. "I give them a lot of credit for where we are today," Bianchi said.

Unfortunately, success stories like Bianchi's aren't always the case, as almost 30% of construction businesses fail in their first two years, according to ConstructConnect. While it can be a result of many factors, one of the largest is ineffective financial management, according to The Surety & Fidelity Association of America (SFAA).

A big part of the problem is that contractors up and down the construction ladder are in a late-payment stranglehold. **In fact, engineering and construction's median days payable outstanding figure is 74 days — the highest of any other industry, according to the 2019/20 PwC Working Capital Report.** Individually, this late-payment paradigm creates a huge cash flow problem for subs, which forces them to continuously float payments and rely on their own credit to cover



costs — and that, in turn, creates a tremendous amount of unnecessary risk for GCs and owners.

“Construction projects are an orchestra of stakeholders, and the GC is the conductor,” said Scott Wolfe, CEO of Levelset, a leading construction payment platform. “When one or many subcontractors are pinched for cash, it can throw the whole piece out of tune.”

The other bad chord payment delays cause is labor shortages from subs who won’t bid on projects because of GCs’ slow payments. And it’s only going to get worse. In fact, pent-up demand from the current COVID-19 construction shutdowns will lead to a “construction tsunami” beginning in the third quarter, according to Keith Prather, market intelligence expert for Olathe, Kansas-based business management consulting firm Pioneer IQ.

To weather that “tsunami,” contractors will have to be ready to respond quickly. “There is a huge cash crunch that is snowballing, and it’s really hurting everyone’s ability to take on more work,” said Frank Skelly, managing director of FK Construction Funding.

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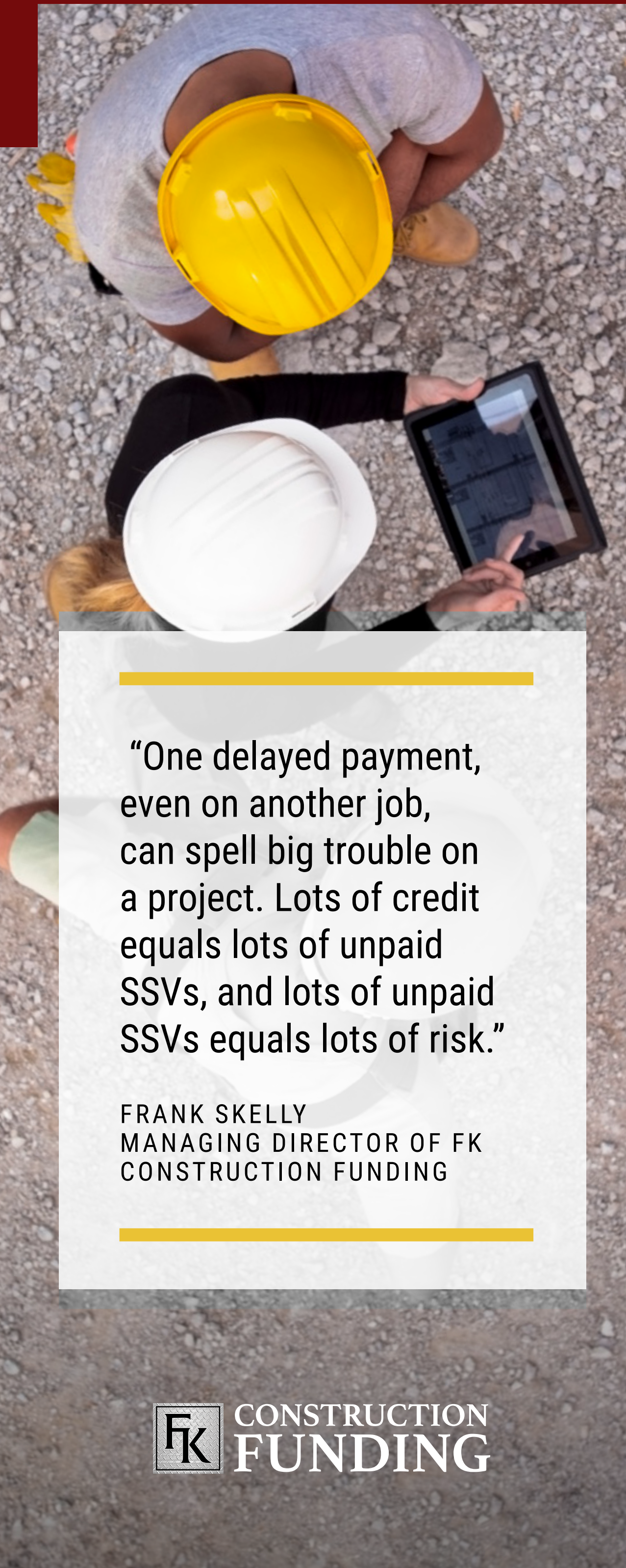

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FRANK SKELLY
MANAGING DIRECTOR OF FK CONSTRUCTION FUNDING

How Cash Flow Issues Affect Business

Day to day, cash flow issues have a major effect on business, according to a 2019 report from Levelset and TSheets by Quickbooks. It found that:

» **16%** of contractors said cash flow issues hampered growth.

» **21%** of contractors said the No. 1 thing cash flow issues affected was payroll.

» **34%** said they drew from personal savings or took out loans to cover labor and materials while awaiting payment.

» **39%** of contractors reported that it still took 30 days to get paid even after invoices had been approved.

» **42%** said they ended up having to pay vendors before they received payment from their GC.

"It's just become the accepted norm: In order to do business in construction, this is what GCs and subs have to put up with," said Scott Burgener, director of project controls at FK Construction Funding. "It's costing everybody money, it's limiting everyone's growth potential, it's creating bottlenecks and it's affecting their ability to take on new business."

Meanwhile, the dramatic growth in the construction sector has left many GCs and owners unaware of the many subs, suppliers and vendors (SSVs) working on their projects — and the liability they represent.

"GCs understand that these risks exist, but really don't understand the actual risk of their specific subs and jobs," Wolfe warned. "They tend to think they are protected from the risks because of their prequalification programs, good relationships, internal processes etc." But many times, subs' cashflow issues don't become apparent until it's too late.

"Even the subs that are pulling it off have no margin for error," Skelly said. "One delayed payment, even on another job, can spell big trouble on a project. Lots of credit equals lots of unpaid SSVs, and lots of unpaid SSVs equals lots of risk."

4 Ways Cash Flow Issues Create Unnecessary Risk for GCs and Owners

Here are four specific ways cash flow issues create unnecessary risk for GCs and owners — and hurt business overall:

1. No visibility or transparency.

Fully 75% of the industry want more visibility into pay as well as payment terms and timelines, according to the Levelset and TSheets by Quickbooks survey. Many GCs really don't have a clear picture of how many other SSVs are working on a project. For large commercial projects, the number can be in the hundreds. And if cash flow becomes an issue, each of those SSVs can use lien rights over the project, which can create delays and cost overruns.

Furthermore, GCs often don't know what their subs are doing with payments — or who's actually getting paid, and more importantly, who isn't. Unpaid SSVs can lead to all types of issues, including work-stopping liens filed against the project. **"When cash leaves the GC's hands, they lose control of where that money goes,"** Wolfe said. "But the GC remains liable if the sub uses the cash to pay other bills. … GCs would like to rely on lien waivers, but a lien waver doesn't protect the GC from claims further down the chain."

2. Lack of proper documentation.

To mitigate risk, GCs and owners need to be constantly collecting documentation, such as the lien waivers Wolfe noted, along with proof of insurance, payroll reports and more. But many GCs are unable to effectively do so. As a result, in a $1 trillion industry, documentation that should be collected contemporaneously is actually being collected several months in arrears, if at all. As a result 58% of contractors file job-stopping liens, the Levelset survey showed.

"It's an arduous process," Skelly said. "Just think about the typical setup — a sub bills the GC and

45-60 days later the GC has a check ready, but needs waivers, and possibly certified payroll and union status letters. So, the sub, who is probably out on a job, has to call the suppliers and try to collect all the waivers. A sub might have 12-15 different SSVs so it can be a big task to collect all these waivers and the supporting documentation when they still haven't been paid and they still haven't paid their SSVs."

3. **Cash flow constraints.**

A strong economy covers up a lot of problems, and many GCs may not realize that subs they thought had strong credit are actually on the brink — and therefore imposing a lot of risk. All that credit means a slew of unpaid SSVs exist.

In fact, subs' financial health is one of GCs' top concerns, along with safety and quality, said Hozefa Mogul, director of procurement for CS Energy, which works with Amps Electric. "When a subcontractor defaults on its financial obligations, the GC is ultimately responsible, and this added risk is something GCs don't want to take on," he said.

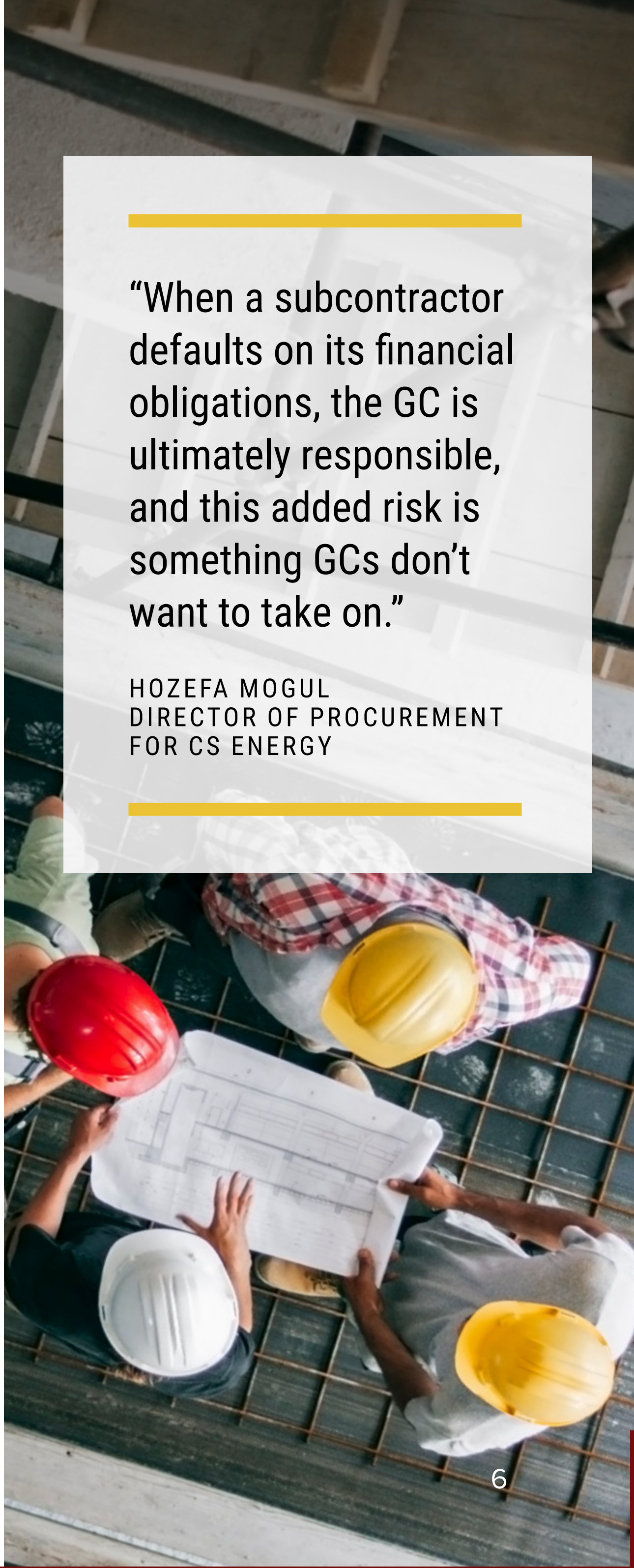
Another issue is unpaid withholding taxes. "We are seeing more and more subs come into our program that have been subsidizing their cash flow by not paying their withholding taxes, which is like having a ticking time bomb on your project," Skelly said.

4. **Labor shortages.**

GCs know all too well how hard it is to find qualified help. But what they may not realize is that a growing number of subs don't even bid on projects because of their own cash flow issues.

A 2019 survey conducted by Rabbet found that more than 60% of subs don't even bid on projects due to GC's reputation for slow payments or because of '*paid when paid*' contract clauses.

"Many subs have painted themselves into a financial corner and end up having to turn down work," Skelly said. In order to remain competitive, GCs and owners cannot afford to have qualified subs sitting on the sidelines when they send out an RFP. They have to find a way to adapt.



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How Cash-Management, Monitoring and Risk-Mitigation Companies Can Help

To address these fundamental problems, more and more GCs and owners are turning to cash-management, monitoring and risk-mitigation companies.

These companies help:

» Manage and fund payroll.

» Establish and maintain supplier credit.

» Manage SSV waivers.

» Collect and manage compliance documents.

» Eliminate cash flow related issues.

» Keep jobs running smoothly and on schedule.

Cash-management companies also allow GCs and owners to see all the SSVs on a job, protecting the integrity of the project from start to finish. And because the fees cash-management companies charge for their services come from SSVs in exchange for early payment, GCs get these benefits at no cost to them.

"When we have subcontractors who do quality work, but we are concerned about working with them because they lack liquidity or the project is larger than their balance sheet can handle, we can still work with them, knowing this risk is being handled by a cash-management company," said Mogul. "This gives us more options. And the best part is that we don't have to pay the premiums."

How to Choose a Cash-Management Company

Not all cash-management companies are created equal. Experts suggest looking for a company that not only addresses the cash flow issues but also offers a cash-management and risk mitigation service, one that takes a funds control approach to the project. That means the company:

» Monitors the subs' license and insurance requirements.

» Collects all required documents, including certified and prevailing wage payroll reports.

» Monitors subs' margins and forecasts their ability to complete the project.

» Oversees IRS withholdings and tax filings; Forms 940/941.

» Promptly issues joint checks to SSVs.

» Collects SSV lien waivers and ensures that union dues are being paid.

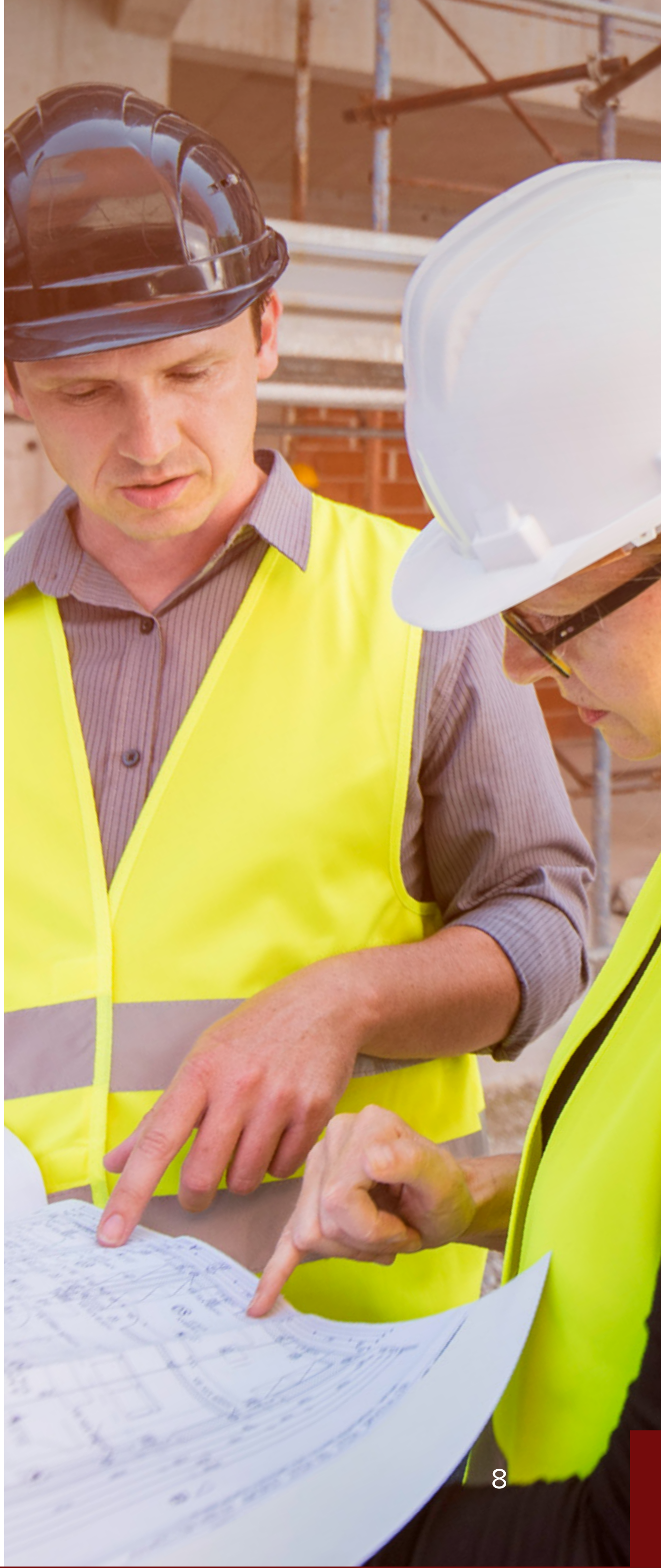
» Ensures pay applications are submitted with the correct backup.

» Clears the job of liabilities monthly, virtually eliminating the risk of liens, judgments and material- and labor-related delays.

» Ensures payroll is being made.

» Has knowledge and experience in the construction industry.

"Without the cash-management, risk mitigation and monitoring pieces it's extremely dangerous," Skelly said. "You never want to deal with a factoring company or any type of finance company that doesn't have the know-how to clear the project liabilities on a monthly basis."



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Conclusion

Many GCs and owners either don't realize or haven't accepted that their subs' cash flow issues put their whole project at risk and that working with a cash-management company is like having a safety net under projects. Shoring up cash flow issues is a great way to not only distinguish yourself from the competition but also to capitalize on future growth opportunities.

The subs enjoy the advantage it gives them, and it's a selling point that offers them the opportunity to bid on more projects, while GCs and owners benefit from the risk it eliminates and the protection it affords them.

"In construction, there's always going to be problems — that's just the nature of the beast," Bianchi said. "So, it's good to have a partner who can help you make sound financial decisions before you get in a bind."

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FK Construction Funding provides cash management, funds control, monitoring and risk mitigation solutions that are custom tailored to the commercial construction industry.
FK Construction Funding has funded over 600 commercial construction projects in 37 states.

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