

CAM/ESD talk for CAM Expo 86 - Wednesday, April 16, 1986 - d038 . . . 1

Number of people expected - about 150 1

Location - Cobo Hall, Detroit 1

Subject - Retentions, Collections and Final Payments in Construction . 1

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Number of people expected - about 150

Location - Cobo Hall, Detroit

Subject - Retentions, Collections and Final Payments in Construction

Program schedule

11:30 AM to 12:15 PM - Cocktails

12:15 PM to 12:45 PM - Lunch

12:45 PM to 12:50 PM - Introductions

12:50 PM to 1:30 PM - Talk

1:30 PM to 1:45 PM - Questions and wind up

I. Introduction - Payment as a lifeline

In Justin Sweet's book "The Legal Aspects of Architecture, Engineering and the Construction Process" Chapter 26 is entitled "Payment: Money Flow as A Lifeline".

Lifeline has many definitions but one in particular strikes me as being most appropriate to the construction profession; it reads "A lifeline is a line or rope for saving life".

Payment or money flow on a construction project can be just that - a line of strength that can preserve the life, vigor and integrity of a project, or a line of weakness that can cast the project adrift.

Successful firms are seldom heard to complain about payment

The successful planner, designer, builder or consultant is seldom found to complain about not getting paid. This bears some close examination for those who seek to emulate these individuals and firms.

II. The general nature of cash flow in the construction industry

-The legal background for progress payments

Governed by the doctrine of conditions

Doctrine of conditions says that a party should not have to perform its promise without obtaining the other party's promised performance.

It is central to any discussion of progress payments.

The question is who is required to perform first?

Common law requires that the performance of services precede payment

This is about all on the legal aspects of progress payments

MY JOB TODAY IS TO DISCUSS HOW TO IMPROVE CASH FLOW BY IMPROVED PERFORMANCE

-The role and obligations of the payer

Maintain a strong financial position that allows prompt pynt when deserved

Makes people want to work for you

Improves potential for future reductions in bid prices
Pay promptly and within the context of the contract
Give example of payment held over Thanksgiving holiday
The lie about the check is in the mail wears thin very rapidly

-The role and obligations of the payee

Too often we in the construction industry blame everyone but ourselves for not being paid what we think is owed us promptly.

Many times the cause of slow or reduced payment lies with the payee, not the payer.

Recognition of this often overlooked fact is something I would like to stress in my discussion with you today

To perform well and in accordance with your contracts
To bill accurately and promptly
To follow the ground rules by which payments are to be made
Frequently the payee holds the key to successful payment for the work

III. The conditions that surround collections and payments

-Unsuccessful

Mistrust - the inability to work honestly with unwritten standards
Cupidity - Inordinate desire to get something for nothing - alerts!

Doubtful risk taking - A high risk has a corresponding high penalty

Ultra conservatism - Excites suspicion and slows cash flow
Mention hotel case in north where job was lost because of a miscalculation of the risk of being paid

Incompetence - Produces a lack of desire to pay or work - no incentive

Claim prone environment

The contested claim brings out the worst in everyone and particularly makes the payee reluctant to pay.

Understanding how to reduce the dust, noise and confusion that surround contested claims often can encourage prompt payment even in difficult conflicts.

- Directed change - 48%
- Constructive change - 42%
- Defective or deficient contract documents - 41%
- Delays - 41%
- Constructive acceleration - 35%
- Maladministration - 33%
- Differing site conditions - 31%
- Impossibility of performance - 18%
- Superior knowledge - 18%
- Termination - 7%

Stubbornness - A balky mule cannot be depended on to pull the wagon
Dishonesty - A total disincentive to play and pay fair!

-Successful

Trustful relation - Construction is a give and take situation
By the end of the job the gives and takes must balance out.
The construction machinery is lubricated by the exchange of
small favors.

Honesty - Honest people who profile right usually don't get hurt
Those who must pay will generally recognize honesty in a
company or an individual if they themselves are honest. The
profile should reflect your evaluation of the payer's
honesty.

Competence - Competent people recognize competence in others
On most jobs, given the presence of a reasonable number of
high value important factors, the competent payee will be
compensated fairly and promptly. The reason is that the
financial check and balance system asks too many "why"
questions to allow competent parties to remain unrewarded.

This is not always the case but more often than not applies.

A willingness to give and take

All taking and no giving by either the payer or the payee
will sink a project in a swamp of paper and a sea of red ink.
The mutual mistrust that results from this lack of informal
give and take will grow to a monster unless its food is cut
off.

Operating a construction elevator for the owner's FFE
Leaving an opening for the owner's laundry equipment
Help from the payer to expedite a difficult delivery for the
payee

IV. Retentions**-Often used for doubtful reasons say some observers**

As a club to assure proper completion

As a way of saving interest payments for 10% of the cost of the
job

As a method to insure construction damage to completed work is
repaired

To pay for anticipated contested claims

**-The problem of retention is old and they will probably
remain a problem**

Until it properly addressed by the parties involved

Until there is agreement among like parties as to its impact

AGC opposing zero retention system of GSA

Contractors opposing zero retention system of State of
Michigan

Until all parties to a contract behave according to their contract

-Attitudes and realities about retention

In 1976 a survey was made of the American Subcontractors
Association (ASA)

Showed the average retention among members was \$200,000

Members said would reduce bid price 3.7% if retention was eliminated

A recent survey of the American Subcontractors Association indicates

- That subcontractors are willing to give lower bids to generals that
 - Pay them promptly
 - Offer them a fair and equitable contract
- Of 200 respondents
 - 89% said they give better bids to generals regularly or occasionally
 - 90% did so because the general had prompt payment policies
 - 91% said not paid within 3 days of billings
 - 69% said not paid within 7 days of billings

Recently adopted policy statement of the AGC, the ASC and the ASA

- Calls for payment to be made within 7 days of billings
- In 1974 GSA went to zero retention
- The Department of Defense eliminated retentions at one time
- The EPA wrote retentions out of its grants at one time

Inquiries this morning indicate

- On a recent federal job 0 retainage was at discretion of contract officer
- That a recent HUD job had standard AIA 50% policy

In 1983 the Office of Federal Procurement Policy wrote a decision

- That a uniform governmentwide policy should be implemented
- Retainage was not to be used as a substitute for good contract management
- The agency cannot withhold funds without good cause
- Determinations on retainage are to be made on the basis of Contractor's past performance
- Likelihood that such performance will continue in the future

Suggested that

- Retainage not exceed 10%
- That it be adjusted downwards as the contract approaches completion
- When contract is complete all retainages be paid promptly

About 1984 SOM Department of Management and Budget went to zero retention

- Required by the legislature
- Had 2 alternatives
 - Put money in escrow
 - Problem - couldn't use state treasury for holding vehicle
 - Problem - private holding would have too complicated
 - Would have thousands of accounts *been*
 - Prohibitively expensive and cumbersome
- Adopt a policy of total payment for completed line items
- Each line item was to be explicit
- On recent \$2,000,000 job
 - Had about 1100 line items
 - Listed on 27 pages
 - Ranged in cost from \$100 to nearly \$70,000

Adopted zero retention route

Some state officials like it, some hate it
Some contractors like it, some hate it
Thus, there is no unanimity in the attitudes or realities of retention

It all seems to depend on whose ox is being gored!

V. Collections, or better yet, payments

-Direct payment from the owner

Conventional method on self financed projects

All depends on the integrity and competence of the owner

-Direct payment from another contractor

Evolved when the general did most of their own work

Today the general might do from 15% to 0% of their own work

Thus the payment process is often used as a weapon rather than a tool

-Direct payment from another party

Usually called the title company method

Steps in disbursement

Monthly draw requests received from the contractors

Supporting documents reviewed by the appropriate tier of contractor

Job inspected by the inspecting architect

Usually hired by the financing source or disbursing agency

Payment made to the contractors directly

Sometimes go directly to subs

Sometimes go to general for disbursement to subs

Done in Minneapolis

Common practice? - probably not so

Advantages

Insures prompt payment to the contractors

Provides third party evaluation to gage performance

Gives financing source full control of the money flow

May diminish the tendency to front load or to unbalance billings

Disadvantages

Removes some of the prime contractor's leverage to get work done

Poorly qualified inspecting architect can create havoc

Bad attitude toward contractors

Jealousy between architect of record and inspecting architect

Creates excessive dependency on attitudes of financing source

Owner plays secondary role in motivating performance

Could happen in a non liable construction management situation

VI. Final payment

-Elements of closing out the job

The punch list and the certificate of occupancy

Usually these provide the rationale behind final payment being made

Decide early how the job is to be punched out

Who is to do it?

When is it to be done?

What standard of performance is to be used to measure acceptability?

When is the contractor's punch list to be prepared?

The operating and maintenance manuals

Quote Fred Campbell re turning over the job

Unsubmitted or inadequate OMM work can be used as an excuse for non payment

Get them done and submitted!

VII. Where successful collections and payment start

-The agreement

The starting point for cash flow success is the preparation and execution of a well understood agreement up front

Often contractors take jobs that specify impossible performance
Leads to getting into a position where the owner, or the architect engineer feel they can withhold payment for personal, subjective reasons, using the impossible clause as a legal reason.

Example: the withholding of payment because the contractor did not submit a acceptable schedule within a given period of time - usually an unreasonable time frame for preparation of a good plan of work and schedule.

Usually not legitimate, but may cause serious delays in releasing payment.

Unfeasible schedules

Inadequate contract documents

Unworkable related contract agreements

Multiple primes

Installation of unknown systems

Undefined responsibility patterns

-The client - either owner or contractor

Most payment-successful contractors profile a prospect before proposing on a job. This is done with any new client, and sometimes on previous clients with doubtful records.

Profiling follows a basic pattern

Identifying what factors describe a good pay client

Honesty in business

Past payment record with you

Past payment record with others

Current financial strength

Nature of assembled financing

Process for approving payment and releasing funds

Attitudes of the architect/engineer

Method of closing out jobs

Fussy and detailed punch lists

Inadequate staff to take possession

Inadequate money to operate the facility
Attitudes toward early completions

Examples are facilities that are finished early and not occupied because of lack of need or lack of operating funds. Schools and prisons are good examples.

Occupancy attitudes

-The project

As with the client, the project must also be profiled. Not every job is for everyone. Be very selective so as to optimize your opportunities for success.

Identifying what factors describe a good pay project for you

Your past experience in building such facilities

The client's past experience in building such facilities

Funding sources

Individuals

Syndicates

Trust funds

Pension funds

Political entities

Payment method

Direct payment

Title company payment

Inspecting architect

Payment method specified to sub contractors

Retention specified

-Evaluating the job

Once the client and project factors are identified, it is necessary to analyze them for a decision as to whether the job is a good job or a bad job. Good and bad is evaluated as to the risk and the return on investment.

Weigh each factor

Weigh each from one to ten as to its importance to you

One - totally unimportant to being paid

Usually if a factor is of no importance to the situation being evaluated it should be eliminated from the profile.

Ten - most critical to being paid

Assign values to the client and the proj which you are proposing upon

Values should be from one to ten

One - Client and project produce worst pay potential situation for factor

Ten - Client and project produce best pay potential situation for factor

Multiply the factor weight by the value to get a profile number

Example of how you might profile the payment potential

Client factors x value for client Jones

Honesty in business - $10 \times 08 = 80$

Past payment record with you - $10 \times 06 = 60$

Past payment record with others - $07 \times 03 = 21$

Current financial strength - $07 \times 05 = 35$

Nature of assembled financing - $05 \times 07 = 21$

Process for approving payment and releasing funds - $08 \times 09 = 72$

Attitudes of the architect/engineer - $06 \times 06 = 36$

Method of closing out jobs - $07 \times 05 = 35$

Project factors

Your past experience in building such facilities - $05 \times 08 = 40$

Client's past experience in building such facilities - $04 \times 04 = 16$

Funding sources - $08 \times 08 = 64$

Payment method - $07 \times 05 = 35$

Total = 515 out of a total possible of 790, or a 65% potential for good cash relationship

Running a few profiles on good and bad payers would give you some history

VIII. Rules for getting paid promptly

- 1. Be certain of your agreement and understand what it says
- 2. Be honest in your dealings and intent
- 3. Fulfil your contract
- 4. Avoid legal entanglements
- 5. Be willing to use the lubricating oil of small favors exchanged

XI. Closing

If you aren't entitled to it don't try to get it!

X. Questions and discussion