

Mitigating risk factors in contractor funding with ConstructionManager

Construction makes up a particularly perilous segment of commercial lending. The standard underwriting procedures that provide ample safeguard in most industries leave banks exposed to a significant level of risk. Statistically, few industries come close to matching construction with regards to fraud claims, and the resulting disputes are often particularly complicated to settle. As a result, lenders are frequently advised to avoid the construction sector, due to the complexity and risk of catastrophic loss.

While this is often the standard approach, it leaves significant market share opportunity for those who have the knowledge and experience required to mitigate these risks. The team at ConstructionManager works to be an industry leader in this regard, providing lenders with a remarkable degree of additional security on commercial construction projects.

AREAS OF RISK

Understanding Contract Language---Construction contracts often exceed 50 pages, and contain a number of industry specific clauses that may be foreign to those outside the industry. This is one area where specialization is key; ConstructionManager utilizes an experienced staff, including in-house counsel, that is knowledgeable regarding construction contracts, and able to recognize areas of potential risk. ConstructionManager offers an **Initial Project Analysis Report** per subcontract agreement summarizing such risks.

Progress billing---Most subcontractor agreements require monthly progress billings. When a progress billing does not represent an accurate percentage of the work performed according to the Schedule of Values, payment setoff often occurs. As such, the Construction Manager team creates, reviews and verifies each invoice/progress billing for subcontracting clients. Such involvement throughout the project allows the lender to recognize developing issues before they are invoiced, funded and potentially setoff.

Complexity of lien laws protecting suppliers of construction jobs—Often, when a project begins to go south, one of the first links in the payment chain to break is the one between subcontractor and supplier. This creates a risk that the supplier will place liens on the project, jeopardizing payment throughout the chain. In order to mitigate this risk, ConstructionManager places a high level of emphasis on monitoring supplier balances, watching for unpaid suppliers, and ensuring that all lien worthy parties downstream are paid on time and in full.

Client Lien rights--Subcontractors are required to satisfy many tasks on each project: Perform the work and supply the materials, carry the financial burden until payment, and satisfy all upstream parties (General Contractor, Architect, Owner and ultimately the project lender). This creates an obvious risk of potential non-payment, and as a result, the state legislative bodies have enacted lien laws designed to address the issues. However, such lien laws vary greatly from state to state, and strict procedural compliance is required in order to preserve the lien rights that a contractor may have. Without adequate attention to detail, lien rights are easily lost,

depriving both the contractor and the lender of any security that would have otherwise been available.

Ultimately, due to the nature of construction, there is no way to alleviate all risk. However, if managed properly, those risks can be greatly reduced, and the complex nature creates potential for above average profitability. This is the ultimate goal of ConstructionManager—to manage risks in such a way as to ensure profitability for lenders.

The Big Question

Is it even worth the risk to extend credit to Contractors whose receivables are based on progress billing?

The simple answer is that yes, the risk is manageable, but only if the lender or a third party monitors specific items throughout the project. Examples of such items include the following:

1. Subcontract terms and conditions
2. Accuracy of progress billing as reconciled against the Schedule of Values
3. Underlying supplier/vendor payments and lien waiver management.
4. Lien rights of client

In the event that the lender is not staffed to perform these tasks on each project, it may choose a product such as ConstructionManager (constructionfunding.com) in order to help mitigate risks throughout each project.

The ConstructionManager program provides lenders with the following to help mitigate the risks associated with funding contractors:

- Initial Project Analysis Report-
- Ongoing Project Analysis throughout the project
- Supplier Lien Waiver Management

In summary, the ConstructionManager product allows the lender to review critical items before each funding decision to mitigate the risk of potential debtor setoff.

Risk is always present in funding contractors. However, with specific safeguards in place by either the bank or a 3rd party such as ConstructionManager, the lending risk becomes manageable, predictable, and profitable.