Good morning. I'm John Woodcock with FBI, where *We Build Better Contractors*. Want to remind you that our next Boot Camp cohort is filling up, so if you've got folks you'd like to enroll in that, please reach out and let Charlotte know.

Today I want to talk about a financial risk topic. Recently, we had a member tell us about a prospective client of theirs, and they had some uncertainty about how that client's project was going to get financed. So, in talking to their attorney, their attorney recommended to them that they get a proof of financing. While they reached out to their peer group members and to us wanted to learn a little bit more about that proof of financing, getting some guidance on the concept. What is it and how does it really alleviate concerns that you're going to get paid for your work? Let me qualify this by saying what we're really talking about here is private work.

When you work for a public entity, there's not much doubt that you're going to get paid. It might take a little bit of time, but that client's not going to run out of money. But if you work for private developers or corporate owners, well there's probably something here for you, especially in this more volatile financial market that we've been in the last 12 to 18 months. Why is this so important? After all, you've got a contract that requires the owner or the general contractor to pay you for the work that you perform. Isn't that enough? Well, the stark reality is it's not. There's a lot of contractors out there that have gotten stuck with millions of dollars of unpaid costs because they relied solely on the contract and their lien rights to ensure that they got paid. Yes, a contract does obligate one party to pay another for the work performed, but a proof of financing is a tool to create greater assurance that this happens.

Now, there's a number of forms that this can take. I'm going to summarize the most common in the next few minutes, and if you find this of interest, reach out to us. We've got a white paper that we're happy to share with you that can go into more detail. Interestingly, the most standard construction contracts create this right for the contractor. In fact, if you're using an AI 201, you'll find it in Article 2, and there is a similar clause in the DBIA contract. Both say that the contractor has the express right to request of the owner and the owner the obligation to provide this proof. But the problem is this language is very broad and it's subject to a lot of interpretation. So, what kinds of proof are possible or customary? Well, if the project is getting funded by a construction loan, you can start with a lender's commitment letter.

These can be helpful, but they're soft and the devil is in the details. You'll need to consider things like the loan size relative to the contract value, as well as the soft costs for things like design, permitting and developer's fees. And what are the conditions to a closing of that loan, and do you think your owner can meet them? Now if you're working for a new contractor where there is really no previous track record, many contractors will ask for a tri-party agreement. That's an agreement that actually obligates the lender to directly fund the contractor for all acceptable work in the event that the owner defaults. These are not easy to get, but we all know what we get when we don't ask. In cases where the contract or the project is being financed directly by the owner, a corporate entity, for example, a review of their balance sheet and their cash reserves is appropriate, verifying that they have sufficient funds for the full amount of the project budget, it's a reasonable request.

And when there are concerns about the owner's future cash flow contractors often will take another step and request either a letter of credit or some cash in escrow and an amount sufficient to cover what your largest exposure might be doing the job. This ensures that the contractor has unfettered access to cash in the event that the owner defaults on payment of their outstanding payouts. Now, you can see that there's a multitude of ways to skin this cat, and in many cases, it really is an art, not a science. And what you need really varies from project to project. Certainly, the quality of the owner and its financial resources plays a big part. Earlier in my career we did a lot of work for a global financial institution. I didn't worry too much about their ability to pay. The parent company signed the contract, which gave us recourse and deep pockets, but we also worked for private developers who set up each project in a thinly capitalized LLC, which was traditional and customary.

Now, the developer had deep pockets, but that offered me little comfort when I considered what might happen if the tenants that they were building for decided to walk away from their lease commitments causing the individual LLC project to lose its financing. The payment terms of your contract as well as your rights to terminate work will also play a big part in determining how much of your own cash might get exposed before you can terminate work and cut your losses. Now, I'm going to pause here and admit that some of you might be skeptical in asking what owner or banker is going to let me or even want me in the middle of their financial deal. Well, that's a very fair point. These can be difficult conversations that you may think indicates a lack of trust. But all we are really doing here is following that sage advice of trust, but verify. Clients are understandably protective of their financial information and their banking relationships, and we as contractors should exercise caution and care when initiating these discussions.

But avoiding this difficult question will leave you completely exposed. So here are a few tips that I hope can be helpful. First, remind yourself that this is simply good business. You're really just validating that your client will pay you for meeting your obligations, nothing more, and as a GC you're ensuring that your value trade partners will be paid too. Be wary of owners unwilling to engage in this issue. We all want to work with clients that say they want a win-win, but an owner that stiff arms the question or deflects the issue may not be the ideal client. Be flexible. There are numerous ways to get more assurances than are offered by a simple commitment letter. I've talked about the most common, but there are certainly other solutions that a collaborative relationship between a contractor and an owner can reveal.

And please don't assume that your lien rights or your right to sue or arbitrate under the terms of the contract protects you. Prosecuting these rights is expensive and consumes an enormous amount of time, time that you really want to spend with your people and your best clients and partners. If you want to dig deeper into this, please let us know and we'll provide a more detailed guide about what you can consider including some of the examples of things we discussed this morning. Thanks for tuning in. Please be sure to drop us a line with any comments on this blog.