2020/2021

Construction Payments Report

Insight into the $100 billion domino effect of slow payments in the construction industry

Rabbet

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INTRODUCTION

How the speed of payments impacts the construction industry

Over one trillion dollars is spent on construction annually in the United States (~$1.36 trillion in 2019[1]). Each year, Rabbet conducts a survey of subcontractors and general contractors about the speed of payments in the construction industry and analyzes the impact on cost for contractors, developers, lenders, equity partners and stakeholders within CRE.

This year's report compares survey data from 2020 with data collected in previous years to examine the accelerating cost of slow payments for the industry as a whole.

2020 SURVEY HIGHLIGHTS

56% Increase in costs associated with slow payments, for a total of $100 billion in 2020, up from $64 billion in 2019.

69% Of subcontractors would offer a discount in exchange for payments within 30 days, resulting in an estimated industry-wide savings of $80 billion, up from $44 billion in 2019.

25% Of all respondents report that work has been delayed or stopped due to a delay in payments to crew members in the last 12 months.

41% Of subcontractors report choosing not to bid on a project due to a general contractor or owner's reputation of slow payments.

183% Increase in subcontractors using retirement savings to float payments.

The construction industry suffers from the longest days sales outstanding of any industry in the US.[2]

Subcontractors experience the primary effects of slow payments directly, including the cost of floating payments for payroll and supplies, higher risk of bankruptcy during downcycles, and challenges in growing a cash-intensive business. In addition, general contractors also face some of these primary effects alongside secondary effects like inflated project costs and delays.

Looking at survey data from both subcontractors and general contractors, the 2019 Construction Payments Report estimated a $64 billion impact on the industry for carrying forward the fees and costs of slow payments. **In 2020, the impact of slow payments has skyrocketed 56% to an estimated $100 billion**.

Rabbet's annual Construction Payments Report demonstrates the primary and secondary costs of slow payments and why all parties in the construction industry should take action to address them.

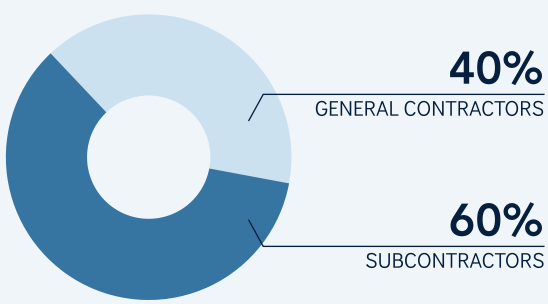
1 Census.gov Historical Construction Data
2 2019-2020 PWC Working Capital Survey

THE STUDY

The survey captured how 99 general contractors and subcontractors across the US managed working capital, bidding decisions, and project risks in the face of slow payments during the last 12 months. Participants completed the online survey during September 2020. Rabbet distributed the survey to contractors representing a wide diversity of trades and would like to thank all survey participants who gave their valuable time to participate in the report.

Rabbet Respondent Profile

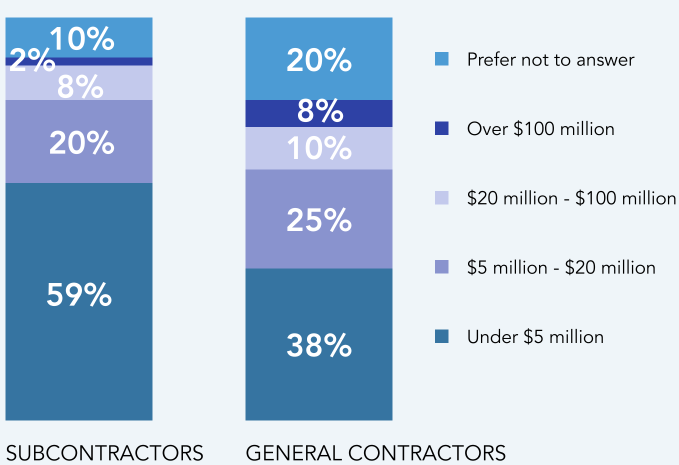
Repondent Breakdown



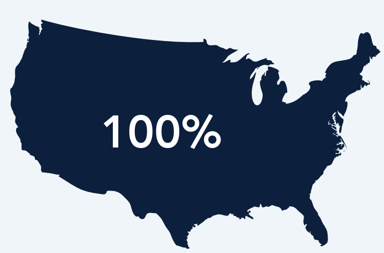
Top 5 Trades Represented

- HVAC
- CONCRETE
- ROOFING
- ELECTRIC
- PLUMBING

2019 Revenues



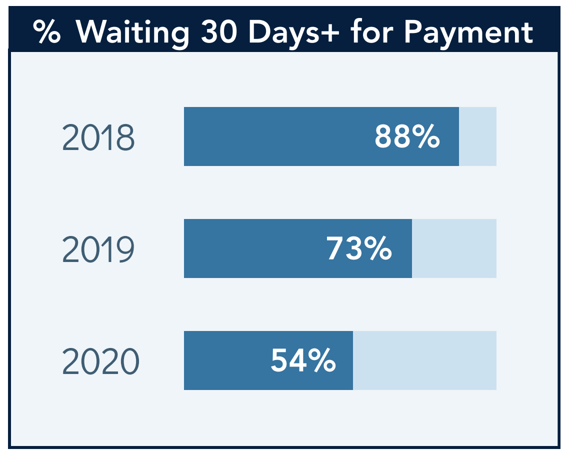
Locations Represented



UNDERSTANDING THE HIDDEN COSTS OF SLOW PAYMENTS

Subcontractors absorb the greatest direct cost for slow payments

Working capital is crucial to contracting businesses. In simple terms, cash flows out of a subcontracting business for wages and materials much quicker than the time it takes for cash to flow in. Wages must be paid weekly or biweekly, and materials are typically purchased on 30-day invoice terms. On the positive side, it appears fewer contractors are waiting more than 30 days for payment than in 2019. In 2019, roughly 75% of contractors reported waiting longer than 30 days to receive payments, with one in three waiting longer than 60 days. Fast forward to 2020 and those numbers have improved; 54% of contractors reported waiting longer than 30 days and less than 15% reported waiting over 60 days for payment.



The waiting game: How subcontractors float payments

Subcontractors turn to many sources of financing for wages and materials while they wait for payment from the general contractor. In 2020, subcontractors report needing to use a wider variety of funding sources than in 2019, including credit cards and personal savings. Only 41% of subcontractors report the ability to rely on their balance sheet, with 46% relying on a line of credit, 36% relying on a credit card and 37% relying on personal or retirement savings. This represents a whopping **183% increase in the use of retirement savings to finance payments** alongside a 53% increase in credit card usage and a 33% increase in contractors dipping into personal savings.

Financing Sources While Waiting for Payment

Source of Financing	2019	2020
BALANCE SHEET	39%	41%
LINE OF CREDIT	36%	46%
CREDIT CARD	22%	**36%**
PERSONAL SAVINGS	15%	**20%**
RETIREMENT SAVINGS	6%	**17%**

The first domino: How financial strain on subcontractors passes through to developers

Despite holding at 3.3% for 2018 and 2019, in 2020 subcontractors estimate that the cost of **floating payments adds an average of 4.5% to total project costs, representing $61B in excess cost** to the industry. This significant cost to developers and stakeholders could be alleviated by improving their ability to make payments more quickly.

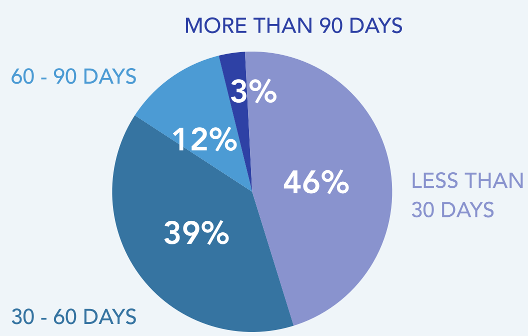
% Increase on Total Project Cost for Subconstractors Due to Slow Payments

2018	2019	2020
+3.3%	+3.3%	+4.5%

Subcontractors

54% Of subcontractors wait longer than 30 days for payment

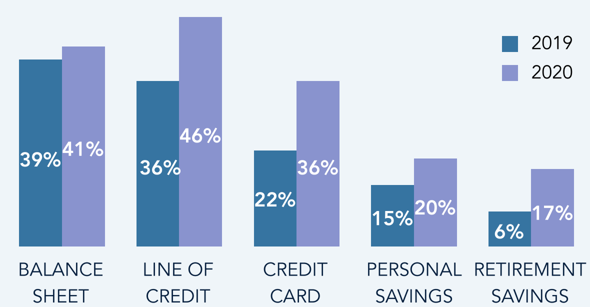
(73% in 2019)



How Long Subcontractors Wait for Payment

68% Of subcontractors incur financing charges while floating payments

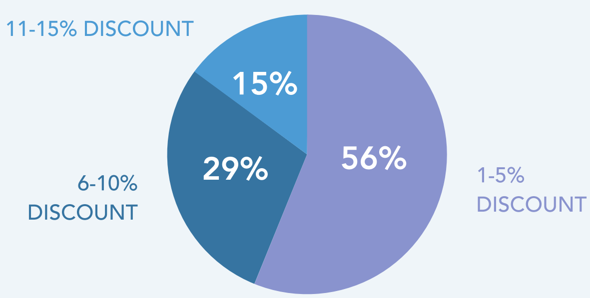
(54% in 2019)



Financing Sources While Floating Payments

$81B Estimated discount subcontractors offer in exchange for payment within 30 days

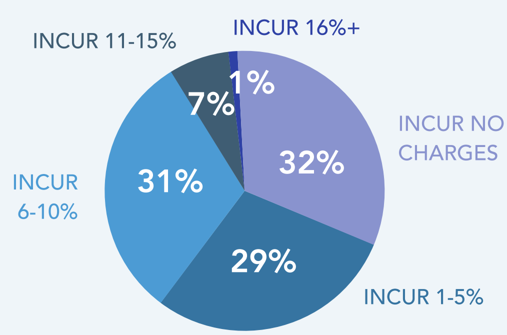
($44B in 2019)



Discounts Offered by Subcontractors

$61B Estimated overhead included in subcontractors' bids to finance slow payments

($40B in 2019)



% of Project Costs Incurred by Financing Charges

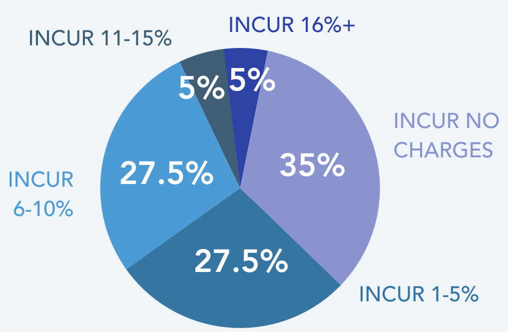
Subcontractors indicate that the value of faster payments is greater than the value of alleviating financing costs. While they report the average cost of floating payments is 4.5%, subcontractors say they would provide an average discount of 5.9% for payments made within 30 days (up from 3.7% in 2019). Even among those who said they did not incur charges for floating payments in the last 12 months, 42% said they would still offer a discount for faster payments (vs 57% in 2019).

The 25% premium subcontractors place on payment within 30 days (vs 12% in 2019) —calculated by comparing the 5.9% discount estimate to the 4.5% cost estimate—sheds light on the hidden value of faster payments. Access to cash is essential for subcontractors to grow their business in an upcycle and survive in a downcycle. In the last 12 months, with the pandemic applying pressure to virtually every industry, 41% of subcontractors report choosing not to bid on a job due to cash flow concerns, although that is down from 63% in 2019. When access to capital becomes more limited in a time of crisis or sudden change, faster payments have the potential to impact the financial stability of the industry in a significant way.

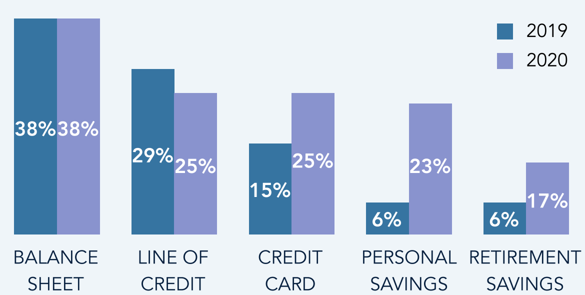
General Contractors

$41B ($24B in 2019) Estimated overhead included in general contractors' bids to finance slow payments

65% (35% in 2019) Of general contractors incur financing charges while floating payments



% of Project Costs Incurred by Financing Charges



Financing Sources While Floating Payments

General contractors aren't immune and still see value in expediting payments for subcontractors. For the second year in a row, Rabbet included general contractors in the Payments Survey to ask about their involvement in the payment cycle. In 2020, three out of four general contractors saw value in paying subcontractors faster, however that was down significantly from 95% in 2019.

39.5% of general contractors report paying at least some vendors more frequently than once per month, and 65% incur financing costs while floating payments (up from 35% in 2019).

The waiting game part II: How general contractors float payments

Similar to subcontractors, only 38% of general contractors say they are able to rely on their balance sheet, followed by a line of credit (25%), credit card (25%), personal savings (23%), and retirement savings (3%). General contractors also indicated a substantial increase in the use of credit cards and savings to float payments in 2020 with the use of personal savings increasing 283%.

Financing Sources While Waiting for Payment

Source of Financing	2019	2020
BALANCE SHEET	38%	38%
LINE OF CREDIT	29%	25%
CREDIT CARD	15%	**25%**
PERSONAL SAVINGS	6%	**23%**
RETIREMENT SAVINGS	2%	3%

The dominoes continue: How financial strain on general contractors passes cost through to other stakeholders

General contractors estimate that **the cost of floating payments adds an average of 4.5% to total project costs** (up from 2.0% in 2019), representing $61 billion in excess cost to the industry (up from $24 billion in 2019). These costs are avoidable if developers and financiers take the right steps to ensure payment efficiency, creating a significant opportunity for improvement in 2021.

DIRECT IMPACTS OF SLOW PAYMENTS

Time

25% *(28% in 2019)*

Subcontractors who reported work delayed or stopped due to a delay in payments in the last 12 months

Money

5.93% *(3.7% in 2019)*

Estimated project savings for payments made within 30 days

Risk

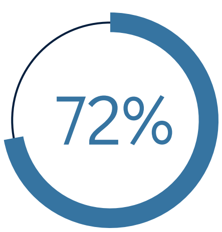
14% *(30% in 2019)*

Subcontractors who report filing a lien due to slow payments in the last 12 months

REPUTATION MATTERS

How contractors bid differently for developers & financiers known for slow payment

Developers and financiers may not realize their role in the overall cost of a project. In addition to the estimated average 7.5% additional project cost (up from 5.3% in 2019) for direct effects from slow payments, subcontractors also factor in a general reputation for slow payments when deciding when and how much to bid on projects.



72% of subconstractors report considering a reputation of slow payments when deciding how much to bid on a project.

Not only are they considering how much to bid, but 41% of subcontractors decided not to bid on a project at all in the last 12 months because of a general contractor or owner's reputation of slow payments (down from 63% in 2019).

An owner's reputation of slow payments threatens the general contractor's ability to earn competitive bids, and this challenge is further compounded in a year already under enormous strain from a worldwide pandemic. When general contractors can't get the best bids from the best contractors, it becomes very difficult to manage project costs and schedules effectively.

Ultimately, all owners, investors, lenders, developers, and general contractors share responsibility for slow payments in the industry. In fact, even though some industry participants are up to five degrees removed from the individuals who purchase materials and perform the work, they are not immune to the cost implications.

Slow payments are an industry-wide problem that requires an industry-wide solution. It is crucial for industry participants to work together to eliminate the manual, complicated processes involved in invoice approval and payment distribution.

Subcontractors and general contractors have long been carrying the burden of slow payments—and all stakeholders suffer from the costs; it is time for owners, investors, lenders, and developers to turn to 21st-century processes and technology to improve the construction industry for all.

TRENDS

The evolution of payment efficiency in 2021 and beyond

Sudden changes to job-site requirements and the introduction of remote work necessitated by the COVID-19 pandemic, forced contractors, real estate developers and lenders to confront inefficiency quickly in 2020. In Rabbet's 2020 State of Construction Finance Report, construction lenders and real estate developers each said over 50% of their current construction finance process could be automated. In fact, over 40% of real estate developers thought their lender's process was inefficient and 70% of respondents believed technology and automation could expedite their process.

Despite being thrust into the spotlight however, inefficiency and slow payments are still a major issue adding unnecessary cost. Trends suggest the domino effect isn't going away in 2021, but the evolution of payment efficiency will continue. Whether you're a developer, lender or stakeholder, these trends and takeaways can help guide your strategy in 2021 and beyond:

Trend	Takeaway
▶ The cost of slow payments in the construction industry is rapidly increasing each year and negatively impacting all stakeholders involved.	**Efficient payment processes reduce cost for everyone.** The impact of slow payments on subcontractors is the first domino causing a chain reaction that extends cost and risk to developers, lenders, equity partners and other stakeholders on a construction project.
▶ Fewer contractors are reporting project delays or withholding bids, but reputation continues to significantly impact contractors' willingness to take on projects.	**Payment reputations influence contractors' decisions.** The events of 2020 may have put many contractors in a position where they do not want to turn down work. However, a reputation for slow payments still adds unnecessary cost to developers' projects.
▶ Fewer contractors are waiting longer than 30 days to get paid, yet a larger percentage are incurring financing charges due to slow payment.	**Monthly payments aren't always good enough.** Faster payments alleviate the necessity for contractors to float payments and incur charges which ultimately get passed down the chain to developers (the domino effect).
▶ While fewer contractors are reporting a willingness to discount, the size of discounts for faster payments are increasing.	**Payment efficiency helps developers obtain discounts.** When payment speed matters to a contractor, it matters greatly. Ensuring payments are delivered quickly increases the probability of earning discounts.
▶ Slow payments continue to add unnecessary risk in the form of liens, project delays and unforeseen costs.	**Expediting payments is critical for risk management.** Inefficient processes that lead to slow payments can derail projects with liens and added risk.

About Rabbet

Rabbet provides cloud-based solutions for commercial lenders, real estate developers, equity partners, and service providers to centralize construction finances, automate administrative tasks, and reduce the time spent managing draws. Based in Austin, TX, Rabbet was founded in 2017, and offers visibility and efficiency across billions of dollars in commercial construction projects.

How Rabbet Works

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