

# Invoice Factoring for Subcontractors

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Invoice Factoring for Subcontractors explores the pros and cons of factoring invoices in the construction industry. The article examines how to determine if it is prudent to accelerate your cash flow with factoring because your subcontracting business is growing rapidly, and no other sources of financing are available.

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If you own a subcontracting business your general contractor normally will pay invoices in 30 to 60 days. This creates a lack of liquidity because your cash flow is on hold for that period of time. This may prevent growth and create difficulties regarding making timely payments to suppliers and your staff. Factoring invoices is a way to accelerate cash flow from invoices by selling them at a discount to a commercial finance company.

{bot\_wrgoogle}The term 'subcontractor' means any person, partnership, or corporation engaged in building construction and who, pursuant to a subcontractor agreement, customarily furnishes labor, materials or services, for a building or structure's construction to a general contractor. The list of subcontractor categories includes: carpentry, communications, concrete, doors, drywall, electrical, environmental services, excavating, flooring, fire protection, glass, HVAC, insulation, masonry, mechanical, painting, plumbing, roofing, waterproofing and demolition.

General contractors bid on jobs to make a profit. They hire subcontractors generally with competitive bidding to make the most profit possible. This puts the subcontractor in a challenging environment. The greater the competition, all other things being equal, their bid price will determine whether or not they win the contract. This squeezes profit margins of subcontractors. Once the job begins, the subcontractor must pay for materials and labor for a considerable period of time, 30 to 60 days or more before payment is tendered for their work.

When a subcontractor factors their invoices they are selling their right to be paid from the general contractor to a commercial finance company. Factoring invoices accelerates cash flow to pay for labor and materials without waiting for the general contractor to be paid. Approximately 75% of the subcontractor's invoice will be advanced, less any retentions or setoffs. When the general contractor eventually pays the invoice the funds will go the commercial finance company. They will deduct their fees and rebate the difference to the subcontractor.

Invoice factoring for subcontractors makes economic sense when they are able to factor invoices profitably as a part of their cost of doing business. For instance, the owner of a rock quarry bid jobs to provide granite rock to highway construction general contractors with the estimated cost of financing always built into the bid. This allowed his company to grow profitably. In comparison, a painting contractor competing with many other bidders might have a gross profit margin that will not support the extra expense of the financing. Subcontractors must "do the math" before they consider entering into an accounts receivable financing contract.

Invoice factoring, which is also commonly called accounts receivable financing,

is more complicated for subcontractors than factoring invoices in the manufacturing or staffing industries. First, the general contractor must agree to cooperate with the commercial finance company. And the terms of the general contractor's contract with the owner, especially public entities, might not allow the invoice factoring to occur. Every invoice to be funded must be verified by the general contractor in writing. There are also issues with mechanics lien laws. This requires subcontractors to pay their major suppliers from the advance or to obtain lien releases as a condition precedent for the advance from the commercial finance company.

Discounts from suppliers can help to offset the costs of financing. The cost of financing is the critical issue to be determined and negotiated. When a subcontractor signs an agreement to factor invoices, there is a blanket UCC-1 lien on all of their invoices. And all of their invoices and cash flow will go the commercial finance company whether or not the invoice has been "sold". Therefore it is critical to understand and agree that the terms of the contract are reasonable and acceptable; this involves analysis of all contractual provisions besides the nominal price of the financing.

In this author's article, Financial Myths vs. Financial Facts there is an extensive discussion of the myriad ways that price may be determined. It pays to read the contract provisions carefully; the nominal price is only one consideration. How fees are determined, the term of the contract, early termination fees, what is the rate charged if there is a default or a dispute- these are just a few of the items to consider. Choice of law is another important consideration. Is the proposed contract pursuant to the law of the state you are doing business in or is it pursuant to the law of a state many thousands of miles away from your headquarters?

The bottom line: Invoice factoring for subcontractors makes sense when the cost of factoring invoices makes the entrepreneur more profitable. Reading the fine print of the contract is essential to this decision.

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