

Give Your Customers Some Credit

by Michael Gorman

If you're not helping your customers secure financing, you're shortchanging yourself. According to a study by Harvard University's Joint Center for Housing Studies, people who pay for home improvements with a loan tend to spend 30 percent to 40 percent more than those who pay with their own cash. These numbers mirror my own experience as a contractor who offered financing to customers for 20 years.

I found that financing appeals to all kinds of customers, not just those strapped for cash. For instance, I had wealthy customers who could easily have liquidated some investments to pay for the job but were told by their financial advisor not to, for the simple reason they might not have the discipline to replenish those investments.

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For the most part, I didn't finance jobs myself. Instead, I educated customers about their various choices and referred them to the companies that offered those options. To perform my role well, I had to understand which credit product made the most sense for a particular customer, and be able to explain all of the benefits of that approach.

Credit Cards

I strongly suggest that you start accepting plastic if you don't already. On small jobs, many people prefer to pay with credit cards, so permitting them to do so will raise your closing rate. But I also had success using this perk to close large projects, primarily by focusing on the frequent-flier miles many cards offer. The tactic worked

with customers from all income brackets, provided they liked to travel.

I saw customers balk at the price of a \$200,000 remodeling project, then come round when I asked, "What if we can offer you two round-trip tickets to Europe?" I'd explain that paying me with a credit card would earn them enough miles for those tickets, and advised them to pay the balance with a home-improvement loan before interest on the card started coming due. If they didn't have a card that offered miles, it was easy enough to get one. If their card had only a \$20,000 credit limit, I'd offer to take payments in \$20,000 increments.

The downside, of course, was the 3.5 percent of the sale price that Visa and MasterCard charged me. I could afford to pay that charge only if I set my prices high enough. Instead of adding the amount to each individual job, I would decide how much credit-card volume I was willing to do, then budget it as part of my overhead.

Home-Improvement Loans

Home-improvement loans are typically 10- to 20-year fixed or variable-rate loans secured by a second mortgage. A creative way to make this option more attractive is to show the homeowners how it can help them with other expenses.

The important point with this type of financing is that on a loan of up to \$100,000, the interest may be tax-deductible. (The homeowners need to check with a financial advisor to confirm this.) Say they want to do a \$50,000 project, but they also have tuition and car loans with a total debt of close to \$50,000. Interest on the tuition and car isn't tax-deductible, but if they take out a \$100,000 loan and use half of it to finance the project and the other half to pay off the tuition and car, they will have substituted tax-deductible interest for nontax-deductible interest.

Same-as-Cash Financing

Some banks will work with contractors on same-as-cash financing, an arrangement in which the customer

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doesn't pay interest if the loan is paid off within a predetermined period — usually 60, 180, or 360 days. The contractor pays the bank a carrying fee and builds that into the price of the job.

When the job is done, the bank takes out a second mortgage on the house for the entire amount, and pays the contractor everything except the buy-down fee. The buy-down fee depends on the interest rate, but can range from 5 percent to 9 percent.

I have found that financing appeals to all kinds of homeowners, not just those strapped for cash.

This is a good tool for homeowners who want to put their house on the market but need to upgrade the kitchen to make it more saleable. With 360-day same-as-cash financing, they can pay off the loan interest-free with proceeds from the sale if the home sells within a year of when the work is completed.

The downside for customers is that if they don't pay off the loan at the end of the term, they will have to pay interest that accrues from the day of the signing. The downside for the contractor is that he doesn't get paid until the job is done. As with credit cards, I always built the price of the fee into my budget.

Mortgage Refinancing

This no longer works for as many people as it did a couple of years ago, when interest rates were at rock bottom. Even today, though, you'll find customers who have higher-than-market interest rates,

and significant equity in the home.

If one of my customers appeared to be a good candidate for a new mortgage, I would sometimes suggest that he or she consider including some money for investments. That could mean borrowing the money at 5.5 percent and placing it in an investment that yields 6.5 percent or more, perhaps tax-free.

Partial In-House Financing

While full in-house financing is typically offered only by contractors with deep capital reserves, even an average contractor can close some sales by financing part of the job price. I've had customers who wanted to build a \$30,000 project but had only \$20,000, so I agreed to finance the extra \$10,000. If the \$20,000 covered the cost of the job, I was basically financing my profit.

To do this, the client would give me legal permission to set up a simple LLC that took out a second mortgage on the house. This loan would have a higher interest rate than the client's first mortgage, as would be the case with any second mortgage. I would determine the customer's creditworthiness using numbers from the credit reporting bureaus, and the client would agree to pay the LLC for the loan.

Although many customers paid off their balances relatively quickly, partial financing created an income stream for my company that I otherwise would not have had. In fact, I used this approach several times per year over the course of two decades to develop a nice side income for my business. And I never lost money.

A contractor for 20 years in Denver, Michael Gorman now runs Tech-Knowledge in Lakeland, Fla., which trains contractors in sales, marketing, and estimating.