# Payment Schedules Everyone Can Live With

by David Dobbs

*A successful payment schedule balances your cash-flow needs and your client's peace of mind*

Keeping payments on track is one of the toughest — and touchiest — aspects of contracting. A good payment schedule covers the contractor's costs while also being fair to the client.

If the schedule is too front-heavy — that is, if the payments are weighted toward the beginning of the job — the client worries about losing his leverage with the contractor. If the payments are weighted too much toward the end, the contractor effectively lends the customer money and runs the risk of losing his shirt should the customer default on those last big payments. A good schedule avoids both problems and is simple to use and understand. This makes it easy for the contractor to get paid and sets clients at ease, reducing the chances they'll balk.

The ideal payment schedule doesn't exist, of course. Creating a good one means balancing various pros and cons, as well as fitting the schedule to the way you like to do business — the way you line up and pay subs, buy materials, manage your jobs, and schedule the work.

Here we look at three different schedules that, with a few exceptions, have protected the contractors who use them while keeping their clients happy.

## Billing at Completed Stages

The most common type of payment schedule is one based on completion of stages of work. Along with a downpayment collected up front (ranging from a few hundred dollars "earnest money" to 5% to 50% of the contracted price), bills of various amounts are tied to the completion of specified stages of work. Typical billing stages correspond to delivery of materials; completion of demolition; intermediate stages such as hanging drywall, cabinet installation, flooring, painting, and landscaping; and substantial completion of the job (often defined by the signing of a punchlist).

The strength of this system is its directness: Due dates are tied to actual events that are (usually) easy to define. Clients can see what they're paying for, the logic goes, so are happy to fork over the money.

***Dickering over what's done.*** The system's weaknesses stem from this same directness. Because payments are tied to substantial completion of specific tasks, clients may balk if they feel — or claim to feel — that those tasks are not substantially or satisfactorily completed. A classic example is when the final payment is held up because of a loose doorknob or other punch-list item. Disputes may also break out in the middle of a job if a client feels that the task in question is not satisfactorily completed. For example, the clients may withhold payment because the framing still lacks some blocking or because they're suddenly not sure they want those cabinets after all, now that they've seen them at the site.

***Establishing an understanding.*** Dwight Griffith, of Griffith-Brilhard Builders of Fallston, Md., feels good client communications can prevent these problems. Griffith bills by the substantial completion method, getting a down payment of 5% to 30% (plus payment for any special orders) to provide startup and earnest money, then billing as stages of work are completed (see Figure 1, next page). Griffin gets quick payment and little argument, he says, by establishing payment points the customer agrees with and then keeping the customer fully informed on job progress.

"We try at contract time to establish a fair schedule that the client is comfortable with," he says. "During construction, we let the customer know exactly how the job is going and when things will be done, so they know when to expect to pay. We don't bill early for things that are almost but not quite complete. I never ask for money until it's rightfully due."

This emphasis on communication and honesty in billing builds trust, says Griffith. The other part of the formula is to be frank about delays, and to document any changes the customer requests.

"Every change order, every request, even if it's to move a window 6 inches, gets documented," says Griffith. "We confirm any agreed-upon changes with a follow-up letter, or, if it costs extra time or money, a change order. We do the work right away. But we send the change order for a signature, so that there's no argument later over what's included or why the schedule was delayed."

Despite these steps, customers occasionally dicker when a bill is presented. If they question whether a stage of work is substantially complete, Griffith tries to reassure them. This may mean walking through and explaining how much of the work is done, and pointing out all the work on other stages that has been done but not yet paid for. This makes it clear that the customer isn't being taken advantage of.

"Sometimes, of course, what they really need is more time to gather the money. If that's the case, we can usually work out something reasonable."

Griffith considers his service-oriented approach a success. In 15 years, he's had to take only two clients to collection. More importantly, he says, his approach fosters a sense of trust that generates the referrals and repeat business that make up most of his work.

**Billing at the Start of a Stage**

Some contractors feel the solution to disputes over substantial completion is to tie payments to some other gauge of job progress. Gary and Kathy Wheatley, of Wheatley Associates in Monkton, Md., tie their draws to the *beginning* of work stages, rather than the completion. Instead of billing at the completion of framing, for instance, the company will bill at the beginning of drywall installation. This method avoids debates over whether the framing is substantially complete while still giving the contractor something to point to — the drywall going up in the bedroom — to justify billing.

***Collecting up front.*** This also keeps the cash flow going in the Wheatleys' favor. Along with a modest earnest money deposit at contract signing (usually $1,000 or less), the company takes a large draw at the commencement of work — usually enough to cover their costs until the next draw. In a typical $50,000 job, for instance (see Figure 2), the Wheatleys collect $1,000 at contract signing, $10,000 the day they start the job, and then varying amounts as they begin different stages of work. For example, the initial draw pays for all the rough mechanical work, demolition, and framing; the next draw coincides with the start of drywall. Wheatley explains the entire payment schedule to the customer at contract signing.

Occasionally a customer objects to this schedule, arguing that he shouldn't pay for work not yet done. Some even point out that other contractors they've talked to bill at completion of work stages. Wheatley counters that such contractors are obviously covering their costs somehow, and that it's his role to execute the building and remodeling, not finance it. If the clients are still uncomfortable with the advance draws, Wheatley will negotiate more, smaller draws, so that he is not so far ahead. That usually quells any remaining doubts.

"If it doesn't," says Wheatley, "we probably can't work with that person anyway."

***Easing into completion.*** The tricky part in this method comes toward the end, since at some point the contractor is no longer starting things, only finishing them, and the client is naturally reluctant to pay for the final few tasks before they are done. So the Wheatleys tie the last couple of bills or so to completions; at that point they are collecting for work after the fact rather than before. To keep things simple, Wheatley ties these payments to tasks whose completions are easily defined — such as setting the plumbing fixtures.

The final payment is collected when the punchlist is signed. At that time, the Wheatleys and the customer negotiate how much the customer will retain until the punchlist is finished. Usually it's about 20% of the final payment. A typical final payment, for instance, due at substantial job completion, might be $2,500, $500 of which the customer retains until the punchlist is finished. (For more on punchlists, see "Putting Your Punchlist to Work," 11/92.)

The system seems close to flawless. But Wheatley warns that, just as with substantial completion schedules, you can get caught if several stages of work get billed all at once and the customer balks or, worse, chooses at that moment to call the whole thing off. That's what happened to the Wheatleys

**Billing at Completion of Work Stages**

***Payment Schedule for $15,000 Remodeling Job***
***Griffith-Brilhard Builders***

| | |
|---|---|
| $4,500 | Deposit at contract signing |
| 2,500 | Completion of demolition |
| 2,500 | Completion of drywall hanging |
| 2,500 | Completion of cabinet installation |
| 3,000 | Substantial job completion |
| $15,000 | Total project cost |

**Figure 1.** *The most common type of draw schedule ties payments to completion of stages of work. This gives the contractor something to point to to justify getting paid.*

**Billing at Beginning of Work Stages**

***Payment Schedule for $50,000 Remodeling Job***
***Wheatley Associates***

| | |
|---|---|
| $1,000 | Acceptance of contract |
| 10,000 | Commencement of work |
| 10,000 | Start of drywall in basement |
| 5,000 | Start of drywall in sunroom |
| 4,000 | Start of trim in basement |
| 3,000 | Start of trim in sunroom |
| 2,000 | Installation of kitchen countertop |
| 4,000 | Start of painting in basement |
| 2,000 | Start of painting in sunroom |
| 2,500 | Installation of floor |
| 4,000 | Setting of plumbing fixtures |
| 2,500 | Signing of punchlist* |
| $50,000 | Total project cost |

*20% of final payment to be retained by customer until punchlist items are complete

**Figure 2.** *By basing their draws on the start of work stages, Gary and Kathy Wheatley maintain a positive cash flow and avoid disputes over whether work is "substantially complete."*

## When the Bucks Stop

One of the dangers of tying payments to stages of work is that if you plan poorly or there are delays in some stages, you may end up with several bills outstanding at once, representing a major portion of the job's total cost. Kathy and Gary Wheatley, of Wheatley Associates in Monkton, Md., found themselves in exactly this position on a recent $120,000 job. Through a combination of unlikely scheduling circumstances, the Wheatleys ended up with $32,000 due all at once.

"We had big bills tied to the beginning of wallboard, to the start of roofing, and to the arrival of the windows," said Gary Wheatley. "As we were finishing the shell, the roofer got delayed. We had started the wallboard but hadn't collected for it. And during the same week, the windows showed up at the site." It was at that moment, with roofing materials, wallboard, and windows all paid for and delivered, that the customers balked.

Wheatley still isn't sure why. "They had never questioned the quality of our work," he said. "Everything seemed to be going along fine; we weren't getting any of those funny signals you sometimes get. But all of a sudden when we had all these bills out, they told us to get out and not come back. They said the siding was all wrong, and that we'd failed to meet the specs, pointing out a few things where we'd missed things by an inch or two. We offered to fix it, but they refused. Instead they had an unlicensed contractor, a friend of theirs, come tear off all the siding we'd put up and finish the job."

When they saw the other contractor at work, the Wheatleys exercised the arbitration clause in their contract to file a claim for the remaining $39,000 due them on the contract. The clients filed a counterclaim for the same amount, claiming that was what it cost to have the job finished. The arbitrator honored both claims, and the Wheatleys went home with nothing.

Wheatley says he learned three important lessons. First, arbitration is only as fair and informed as the arbitrator. He also learned the importance of staggering any work stages tied to billing and to bill and collect promptly whenever a stage begins, so the associated bills can't pile up.

But the most vivid lesson, says Wheatley, is that "if someone really wants to put it to you, they'll find a way to do it." In retrospect, Wheatley says it seems the clients probably intended all along to default on the contract and let their friend finish the work. Having three different bills pile up at once just made it easier.

*— D. D.*

**Figure 3.** *Contractors Jeff and Teresa Santerre bill every job in a series of equal weekly installments. They've found that customers like this method's simplicity and predictability.*

## Billing Weekly

***Payment Schedule for $72,498 Remodeling Job***
***Prestige Custom Builders***

| | |
|---|---|
| $3,625 | Deposit at contract acceptance |
| 8,156 | Due Wednesday, August 12, 1992 |
| 8,156 | Due Wednesday, August 19, 1992 |
| 8,156 | Due Wednesday, August 26, 1992 |
| 8,156 | Due Wednesday, September 2, 1992 |
| 8,156 | Due Wednesday, September 9, 1992 |
| 8,156 | Due Wednesday, September 16, 1992 |
| 8,156 | Due Wednesday, September 23, 1992 |
| 8,156 | Due Wednesday, September 30, 1992 |
| 3,625 | Due Friday, October 9, 1992 or upon substantial completion |
| $72,498 | Total project cost |

on a $120,000 job about a year ago. With roofing, windows, and drywall all bought, delivered, and starting to be installed — representing almost a third of the $120,000 total job cost — the customer threw them off the site and refused further payment (see "When the Bucks Stop," previous page).

### Billing Weekly

If you feel the simplest solution is the most reliable, then consider the system used by Jeff and Teresa Santerre, of Prestige Custom Builders in Seattle, Wash. The Santerres bill virtually every job in a series of equal weekly increments.

The formula is simple: At contract signing, the company collects a 5% deposit, plus the cost of any special-order items. Another 5% is earmarked for a "punchlist complete" payment — the customer's retainage, to be collected when the punchlist is finished. (The Santerres sometimes let the customers negotiate this retainage percentage to as much as 10% of the total.) The remainder of the price is then divided by the number of weeks the job will take. An eight-week job, in other words, will have ten payments altogether: the 5% deposit, then eight equal weekly installments (all collected on Wednesdays, when Jeff Santerre makes his rounds), and one final payment of 5% when the punchlist is done (see Figure 3).

What if the job falls behind? As long as the critical tasks on the job's Critical Path Method (CPM) schedule are on track, the bills are due as scheduled. If the critical path falls behind, the payment schedule is delayed accordingly until the job is back on track.

***Every Wednesday.*** "The clients love the predictability of this method," says Santerre. "That makes it much easier to collect, and it saves us tons of paperwork preparing statements to justify the bills. It's simple: The clients know that every Wednesday I'll be by to say hello and see how things are going, and, as long as the jobs are on schedule, they'll need to have that check. After a couple of times, I generally don't have to ask for it."

***The worries.*** Santerre says that when they started the method, they were concerned that customers would be uncomfortable because bills did not directly relate to completion of specific tasks. But the clear documentation the Santerres provide — the CPM schedule, along with an elaborate Construction Specification Institute (CSI) breakdown of costs — apparently reassures their clients, for none have objected to the system, and most of the firm's clients come from referrals or repeats.

Obviously, for this method to work smoothly, the job must stay on schedule. To ensure this, the Santerres cultivate good relationships with their subs (their predictable cash flow helps), and in return, the subs make the schedules work.

The Santerres also have a solution for the other schedule wrecker — the change order. When a change order is executed — a scope of work verification request, as they call it — the document includes not only a dollar amount the change will add or subtract from the total, but the number of days the change will add or subtract to the CPM schedule. This way, the schedule adjusts itself to accommodate change orders, so the payments can stay on track. The change orders themselves are billed separately, and are due within ten days of their execution.

"We're always fine-tuning our business," says Teresa, "but this is the one area where we feel we've really got it where we want it. We've had no real negative feedback. And between the predictability of cash flow and the paperwork it saves us, it makes our lives a lot easier." ■

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