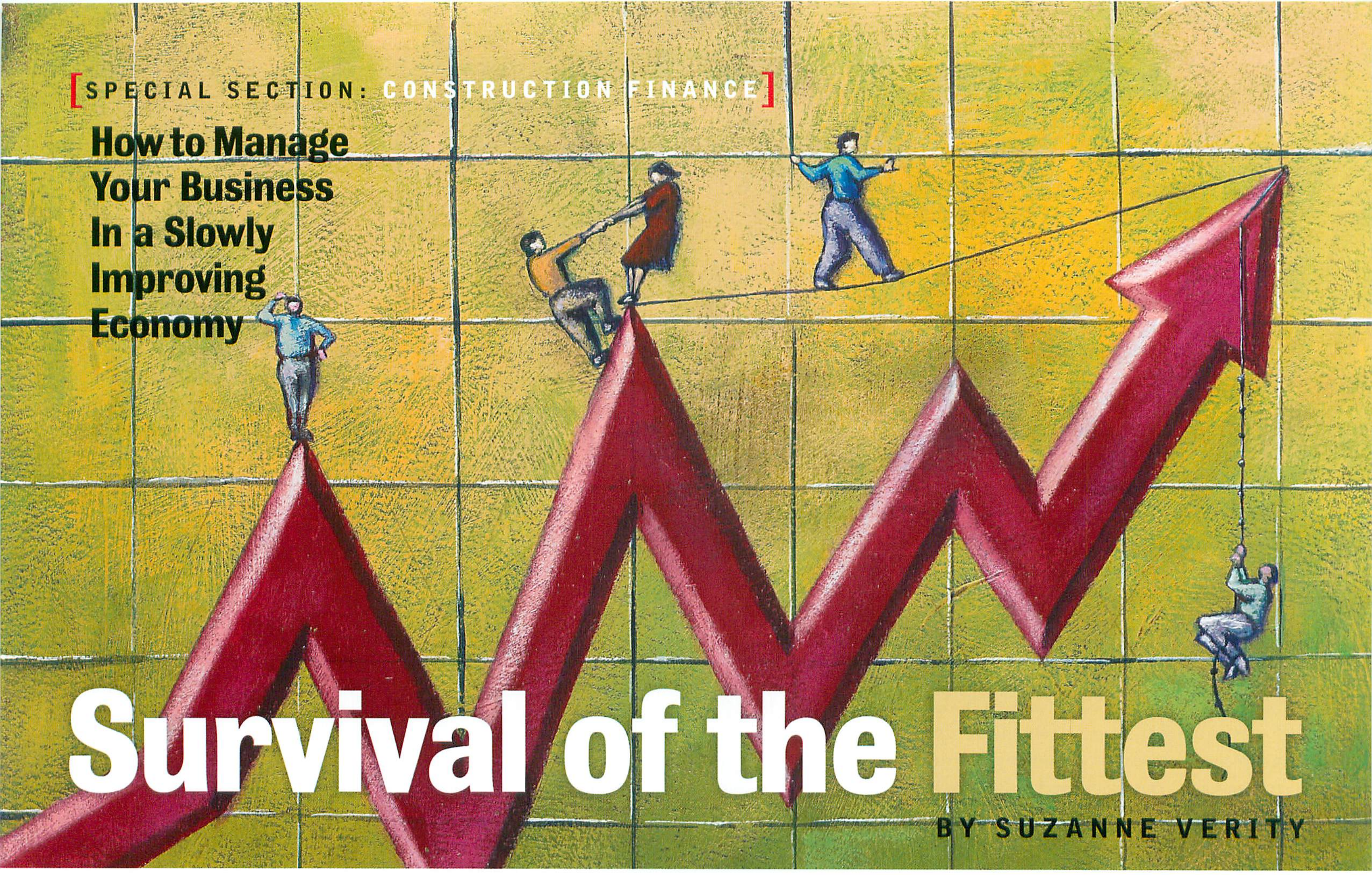

[SPECIAL SECTION: CONSTRUCTION FINANCE]

## How to Manage Your Business In a Slowly Improving Economy

# Survival of the Fittest

BY SUZANNE VERITY

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At times like these, it helps to remember the economy is cyclical. What goes down will eventually come back up. And construction contracting—a service that is difficult to outsource to another country—is a necessity during a period of expansion.

"As population demands grow, construction and infrastructure needs are imminent," says **Teresa S. Godar**, CPA and director of construction industry services with St. Louis-based **Mueller Prost PC**.

But the early stages of an economic recovery are often the most perilous. The contractors best positioned to thrive are the ones that have taken the lessons of the recession to heart.

"Contractors that have built a firm foundation, weathering the storm with fast action through cost cutting and efficient productivity plans, have positioned themselves as survivors," Godar says.

### WATCH OUT FOR QUAGMIRES

Surviving the recession doesn't necessarily translate to surviving the recovery. Two primary dangers loom for unwary business owners.

1. **Hiring too soon.** It's natural to be eager to rehire or replace laid off workers, but be cautious and take time to get a feel for who's out there. "Find out who is available by going through your trade associations," says **David Thompson**, CPA and partner with **Hutchinson and Bloodgood LLP**, San Diego. "And tap into a good recruiter—someone who specializes in the construction industry. You'll have better results than if you do the search yourself."
2. **Taking on jobs beyond the company's capabilities.** "Be wary of the very large job," says **Jay Rammes**, CPA and director with Cincinnati-based **Barnes Dennig**. "Volume has been low for a while, and the large job may be very tempting, but remember that bigger is not necessarily better. Large jobs that you don't have experience with can lead to logistical management issues and quickly get out of control, leading to large losses." By the same token, taking on a job of any size outside of the company's comfort zone is risky. "Be diligent to stay in the market and niches in which you have been successful in the past," Rammes advises.

### UNDERSTAND COST STRUCTURE

The key to correctly calibrating resources with opportunities is a thorough understanding of the company's cost structure, which likely has changed in recent years.

Contractors need to understand their costs, refine their estimating strategies and develop realistic budgets.

"Only through that process can contractors understand how much they need to bid to be profitable on a job and the target volume they need to make money overall," Rammes says. "After refining your understanding of your cost structure, you may find that you can bid lower than you thought."

Accurately allocating overhead is one of the keys to contractors' profitability—and also an area that frequently is given short shrift. "With the slowdown, many companies are anxious to get back to work and forget to include these costs in their estimates, further delaying their return to profitability," says **David McLellan**, CA and partner with **Catalyst LLP Chartered Accountants**, Calgary, Alberta.

Reviewing past project budgets is only one part of developing new accurate budgets. "The old burden percentages of direct labor may not be accurate anymore," Rammes points out.

Contractors also need a solid understanding of what has changed in their overhead structure and a realistic, conservative forecast of revenue for the upcoming year based on the current economy and company backlog. "A good CPA business partner can be very effective and, more importantly, objective in helping you set these goals," Rammes says.

Be sure to work with correct numbers by monitoring job cost reports on a weekly basis and comparing those costs to budget. "Project managers need to provide accurate costs to complete the jobs, and any potential overruns need to be reviewed and solved as early as possible," McLellan says.

### KEEP UNDERWRITERS HAPPY

A key factor for contractors in successfully riding the wave of recovery is keeping sureties and lenders on their side.

During a time of financial instability, regular communication with underwriters is especially important. Contractors should set up quarterly meetings with the surety to discuss the status of bank credit, types of projects being bid, the company's strategic plan and its overall financial health.

"Regular and open communication builds trust between the parties and can minimize the risk of a surety reducing the company's bonding capacity at a time when it may need additional capacity," says **Chip Dillman**, CPA and senior audit manager with **Greer & Walker LLP**, Charlotte, N.C.

Sureties and lenders are like detectives investigating a contractor's financial health, and financial statements are the primary source of clues as to how the story will unfold.

"Over a period of time, patterns are established that provide an invaluable indication of a firm's ability to operate successfully in a particular economic or construction market," says **Mark Freed, CPA** and partner with **Andrews Hooper Pavlik**, Midland, Mich. "For example, they indicate how well the contractor prices its product and whether future profitable operations can be maintained."

While hungry contractors might think volume is the answer to obtaining more bonding capacity and credit, underwriters actually look for conservatism. "They don't want to see a feeding frenzy," Thompson says. "They want to see the same controls in place during a time of expansion as they would see when the contractor is at full capacity."

In addition to moderation in the jobs being pursued, fiscal conservatism is important to sureties. "The recession has forced companies to learn how to be much more efficient and logical with their spending policies," Rammes says. "As you become more profitable, don't give profits back by returning to the days of unnecessary spending. Keep a tight lid on your cost structure."

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## How to Lessen the Impact Of Tax Increases

People have been complaining about taxes for as long as they've been paying them, but the uncertainties and opportunities that exist today may be greater than at any other time in recent history.

Unless Congress acts before the end of the year, Jan. 1, 2011, will be a "day of reckoning" when federal tax rates increase on ordinary income, capital gains and qualified dividend income. The new health care law also contains a myriad of new taxes, such as increased Medicare taxes on ordinary and investment income starting in 2013.

"These taxes suck much-needed capital out of businesses and will negatively impact their ability to rebound from the recession," says **Adam Polakov**, a CPA with Atlanta-based **Porter Keadle Moore LLP**. "Plus, businesses are wary of expanding because they are uncertain of what new tax or regulation will be imposed."

For companies willing to invest the effort, the following tax incentives can lessen the impact of these expected increases.

- **Code sections unique to the construction industry.** Certain code sections provide a deduction of up to $1.80 per square foot for energy-efficient commercial building expenditures on lighting, HVAC and building envelope systems. "Contractors working on applicable government jobs have a unique opportunity to have the deduction assigned to them, since the government entity can't take it," says **Teresa Godar** of St. Louis-based **Mueller Prost PC**. In addition, the contractor has an opportunity to educate the building owner on how to accelerate deductions, which typically take up to 39 years to recuperate.
- **Cost segregation studies.** Cost segregation involves analyzing the components of a building project and segregating those costs for depreciation purposes. Even if the contractor does not own the property, the accelerated depreciation will improve cash flow to the owner, making potential projects and change orders easier to manage.
- **Research and experimentation.** R&E credits reward companies for investing in innovation and improvements. "Design-build contractors have an incredible opportunity to benefit from these credits," Godar says. "In addition to being able to apply for the credits themselves, when a manufacturer hires a contractor to make plant adaptations for improved efficiencies or productivity, the R&E credits again can reduce the overall construction costs."
- **Hiring incentives.** Several tax credits exist to encourage employers to put people back to work. The federal Work Opportunity Tax Credit can be as much as $9,000 for each new hire from certain targeted groups, according to **David Thompson** of **Hutchinson and Bloodgood LLP**, San Diego. Employers also may be able to take tax credits for employees who live and work in a state or federal renewal community, empowerment zone or enterprise zone. The Hiring Incentives to Restore Employment Act gives a Social Security payroll tax exemption to any business that hires workers who have been unemployed for at least 60 days. This exemption is available for workers hired after Feb, 3, 2010, and wages paid after March 18.