Construction

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Health care act: The time to start planning is *now*

It's been nearly three years since the Patient Protection and Affordable Care Act was signed into law. And given the controversy and attempts to dismantle the act, many businesses adopted a wait-and-see attitude about its requirements. But now that the U.S. Supreme Court has upheld most of the act's provisions and the November elections have preserved the balance of power in Washington, it looks like the health care act is here to stay, at least for the foreseeable future.

Some of the act's key requirements for businesses take effect in 2014, so it's a good idea to start planning now.

Does the act apply to you?

The first step is to determine whether the health care act's requirement to provide employees with health insurance applies to your firm. Generally, the act's coverage requirements are limited to "large employers," defined as those with 50 or more full-time-equivalent employees (FTEs) in the preceding calendar year. (See "How many FTEs do you have?" on page 3.)

Generally, the act's coverage requirements are limited to "large employers," defined as those with 50 or more FTE employees in the preceding calendar year.

Keep in mind that your firm won't be considered a large employer if the number of FTEs exceeds 50 on no more than 120 days during the preceding year. If your firm is near the 50 FTE threshold, you may have an opportunity to avoid classification as a large employer by shifting work to independent contractors or seasonal workers, neither of whom count toward the number of FTEs. (A seasonal worker is one who works fewer than 120 days per year.)

What does the act require?

If your firm is a large employer, it's not *required* to provide employees with health insurance. But if it doesn't — and at least one employee receives a premium tax credit — it will be subject to penalties beginning in 2014. (Under the health care act, premium tax credits are available to employees who meet certain income requirements and don't have access to affordable employer-provided insurance. They're designed to subsidize the purchase of health insurance on one of the state insurance exchanges established by the act.)

The penalty is $2,000 per full-time employee (defined as an employee

working 30 or more hours per week), excluding the first 30 employees. So, for example, if your firm has 100 full-time employees, the penalty would be $2,000 × 70 (100 – 30), or $140,000.

Even if your firm provides health care coverage, it may still be subject to penalties. This can occur if the coverage doesn't satisfy minimum essential benefit requirements or is deemed to be unaffordable. Generally, a plan provides *minimum essential benefits* if it pays at least 60% of the actuarial value of covered expenses and meets certain other requirements. And it's *affordable* if the employee's share of the premium doesn't exceed 9.5% of his or her household income.

Employees for whom these thresholds aren't met are eligible for premium tax credits. The employer penalty is $3,000 for each employee who receives a subsidy or, if less, $2,000 per full-time employee.

How many FTEs do you have?

To determine your number of full-time equivalent employees (FTEs), you'll need to consider both full- *and* part-time workers. Full-time employees are those who work 30 hours or more per week, excluding seasonal employees who work fewer than 120 days per year. To convert part-time workers into FTEs, divide their total monthly hours by 120.

For example, let's say your construction company has 25 full-time employees and 42 part-time employees who work 80 hours per month. Total monthly hours for part-time employees are 3,360 (42 × 80). Dividing 3,360 by 120 results in 28 FTEs, for a total of 53 FTEs.

What's the next step?

If your firm is a large employer, is already providing health care coverage and would like to continue to do so, your next step is to determine whether that coverage will be sufficient to avoid penalties. This means looking at whether it provides the minimum essential benefits and is affordable.

If you aren't already providing coverage and would prefer not to start, your next step is to determine whether it's feasible — and practical — to avoid penalties by reducing your number of employees below the 50-FTE threshold. You may be able to accomplish this by simply shifting work to independent contractors or seasonal workers.

If your current coverage won't be sufficient or classification as a large employer is unavoidable, work with your CPA to compare the cost of improving or providing health care coverage with the cost of paying penalties (keeping in mind that penalties aren't deductible). Of course, you also need to consider the other benefits of providing good health care coverage, such as attracting and retaining the best employees.

Additionally, you might consider strategies for minimizing penalties, such as hiring more part-time workers or independent contractors in place of full-time workers. Although part-time workers count in determining whether your firm is a large employer, only full-time workers are considered in computing penalties.

Are you eligible for tax credits?

If your company has fewer than 25 FTEs, check whether you're eligible for small business tax credits for buying group health insurance. If you have 10 or fewer FTEs with average annual wages of $25,000 or less and you contribute 50% or more of the total premium, you can claim a credit equal to 35% of your cost. Partial credits are available for companies with fewer than 25 FTEs and average annual wages under $50,000.

Beginning in 2014, small businesses that buy insurance through an exchange and contribute at least 50% of the total premium can claim a credit of up to 50% for two years.

Be prepared

If your business already provides affordable health care coverage that meets minimum essential benefit requirements, the health care act likely won't have a big impact on your business. If you don't provide adequate coverage, however, you may be required to provide coverage beginning in 2014 or pay a stiff penalty, depending on the size of your company and the makeup of its workforce. Be sure to work with your CPA to determine the best course of action. ■

Boost your bonding capacity with shareholder loans

In the current environment, conservative underwriting standards and low bond limits have made it more difficult for construction companies to obtain the surety credit they need.

One strategy for enhancing your construction business's financial position and boosting its bonding capacity is to have the owners make loans to the company. So long as these "shareholder loans" (which can also be made by entities other than corporations — such as LLCs and partnerships) are subordinated to bond claims, most sureties will treat the proceeds as a capital equivalent in evaluating a company's bonding capacity.

Debt vs. capital

Why not beef up your balance sheet by simply infusing it with new capital — either through additional owner contributions or with money from outside investors? Because such infusions can have significant disadvantages. Bringing in outside investors would dilute the current owners' interests. And, additional owner contributions can lead to undesirable tax consequences.

A surety will consider the source of loan funds. Loans should come from the owners' personal funds, or distributions from the company.

If your business is organized as a C corporation, for example, any paid-in capital would be subject to taxation at the shareholder level — if it were later paid out as a dividend. For other types of entities, double taxation isn't an issue, but distributions generally reduce an owner's basis, which may have negative tax implications.

With shareholder loans, on the other hand, principal payments typically aren't taxable (unless, in the case of certain pass-through entities, the shareholder's basis in the loan has been reduced by business losses or other adjustments). Plus, interest payments, although taxable to the owner, are deductible by the construction company. Loans also provide an advantage in the event of the company's bankruptcy, because debt is generally paid before equity is returned.

Subordinated loans

A surety will view a shareholder loan as a capital equivalent only if the loan is evidenced by a promissory note and the contractor signs a subordination agreement. The loan should be structured and documented carefully, with a market rate of

interest and commercially reasonable terms, to ensure that it's treated as a legitimate loan rather than a contribution to equity.

A subordination agreement provides that the loan is subordinate to all of the surety's rights and claims against the business in connection with furnishing a bond, and that the surety will be paid in full before any payments are made to the shareholder. In addition, in the event of the construction company's bankruptcy or insolvency, the agreement assigns to the surety any rights the shareholder may have against the company in relation to the loan.

The surety will also consider the source of the funds. Loans should come from the owners' personal funds, such as salaries, bonuses, dividends or distributions from the company. Sureties generally frown upon loans made from borrowed funds (for example, an owner borrows money from a bank and lends the proceeds to the company), for fear that shareholder loan proceeds will be used to pay back the lender.

Performance matters

Shareholder loans and subordination agreements, by themselves, aren't enough to provide a surety with the comfort it needs to extend credit. To boost your bonding capacity, you must still satisfy the surety that your construction company is financially healthy and that prospects for future growth and profitability are strong. ■

Profit fade got you down?

Unfortunately, profit fade has been the undoing of many contractors. This financial malady often occurs as a contract nears completion. If you've experienced profit fade on a past project, you know how frustrating it can be to see your expected profits going down the drain. Here's how to nip the problem before it nips you.

Stay on top of project swings

The profit you calculate when bidding a job can fluctuate dramatically as work progresses. For every phase finished under budget, there may be an unexpected problem waiting to wipe out the savings. If you want to end at the top of the arc, stay on top of each project's swings.

Every significant cost increase should be accompanied by a change order that increases the contract's value. If it isn't, determine why. Was your initial estimate off? Or have you done extra work that wasn't covered by a change order? In either case, you're headed for profit fade, and you must find ways to get the job back to "profit friendly" status.

Study past contracts for clues

In addition to monitoring work in progress, study your estimating and profit histories. Review jobs that didn't work out so well to determine where they didn't meet budgets and whether expenses were allocated properly.

Ask your supervisors whether the assumptions you used in estimating the projects were valid. Did you, for example, realistically calculate the number of bricks your crews could lay in a day? Were your average labor costs accurate?

Also consider direct and indirect costs, and compare estimates on jobs that lost money to those on profitable projects. Use those results to improve estimating procedures on future projects. If, for example, projects were delayed because you expected your project manager to obtain final foundation design approvals and shop drawings while also getting the job under way, revisit your staffing estimates.

If there's a problem, remember that your leverage is strongest before the project is finished.

Look, too, at whether certain owners cost you money. If an owner consistently moved walls or added doors, be sure that any future contracts with the owner include specific language regarding scope and specification changes, change orders and schedule revisions.

Get a handle on contract language

Before work begins, understand fully what you're contracted to do. Contract language is often unclear, resulting in differences in interpretations that can disrupt and delay projects. Conducting a careful review of the contract and clarifying any uncertainties at the start of the job can help prevent disruptions and delays going forward.

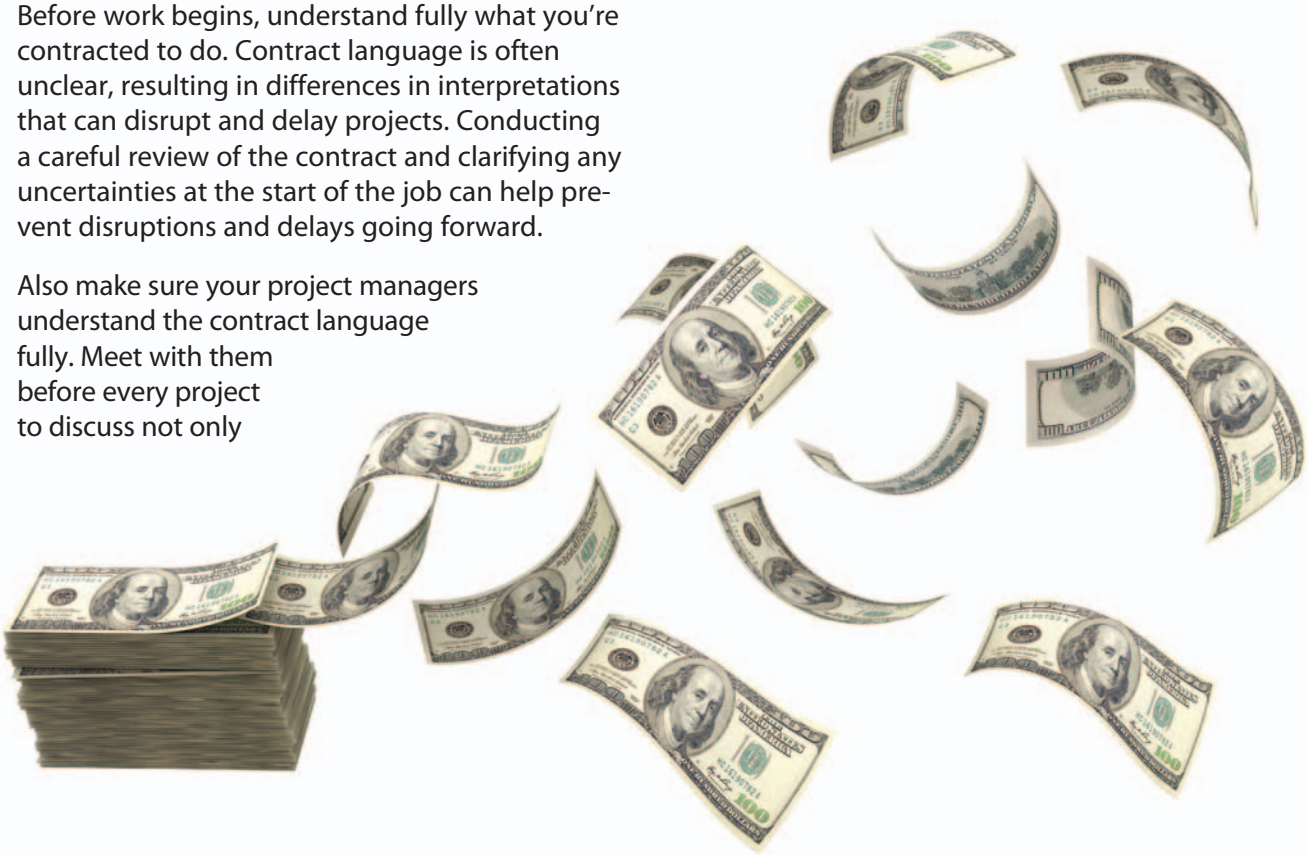
Also make sure your project managers understand the contract language fully. Meet with them before every project to discuss not only the contractual provisions for scope of work and change orders, but also what you bid and why.

As work progresses, meet with your project managers regularly to make sure they're comparing their actual costs to the bid cost amounts. If a problem arises, they can address it with the owner immediately. They should also note the reason for the issue. For example, if you're typically plagued by weather delays during a certain time of year, you may need to build a little more time into your bids.

If there's a problem, remember that your leverage is strongest *before* the project is finished. Owners need your help to meet their goals, and they may be more amenable to approving change orders while you're still on the job. If you wait until the project is done, an owner will have use of the facility and may not release your retainage. In other words, they're holding all the cards.

You *can* overcome profit fade

If you understand how profit fade works, you're on the right track toward lessening its impact on your bottom line. Just make sure you do your homework, expect the unexpected and write clear, specific contracts. ■



How CRM can help you become more profitable

In today's highly competitive construction industry, customer relationship management (CRM) systems can provide contractors with a competitive edge. A CRM system is much more than a sophisticated electronic address book. It can help you improve customer service, direct limited resources where they'll be most effective and win new business.

Staying up to speed

Essentially, a CRM system is a powerful, centralized database that captures in one place all relevant information about customers, projects, prospects, business partners and other contacts. Typically, this information is accessible both in the office and remotely.

As a result, CRM allows your team members to get up to speed quickly on the status of a project or lead. If, for example, a customer calls with a question or complaint and the primary contact isn't available, anyone at your company can use the CRM system to learn about the issue and any recent communications on the subject.

Focusing your efforts

From a business development perspective, CRM can help your company direct its limited resources to projects likely to yield the greatest returns. By integrating CRM with other systems — such as project management, job costing and estimating — you can build profiles of your most successful projects by client, industry sector, geographic location and other factors.

You can also track your win-loss record on previous bids. This information enables you to focus efforts on projects you have a high probability of winning and that are likely to be profitable.

Winning new business

CRM can further help you improve your chances of winning new business by standardizing and automating the business development process. For example, a CRM system can:

- Capture all information about a business opportunity, including the nature of the project, names and background of all key players, and bid deadlines,
- Manage and track all sales activities and tasks, including e-mails, phone calls, meeting notes and so forth,
- Provide reminders for personnel of key tasks or deadlines, and
- Help coordinate relationships with key business partners, such as subcontractors, engineers, architects and consultants.

You can even use CRM to help manage the contract negotiation process.

Avoiding the cracks

Most construction businesses have ample customer information already, but often it's found only on paper or in multiple databases or spreadsheets. By centralizing this information, CRM can reduce the chances that something will fall through the cracks. This, in turn, can help strengthen customer relationships, enhance focus and, ultimately, increase profitability. ■