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Are your equipment costs in gear?

You can stay ahead of the curve on your equipment costs when you fully understand the reasons and benefits associated with buying, leasing and renting equipment. There is no right or wrong choice — each option has its own merits.

Buying

If you use your equipment at or near maximum capacity and maintain that level of use, buying may be your most logical choice. Keep in mind, however, that while you may use your equipment extensively during peak times, it may be difficult to maintain that level of use every day.

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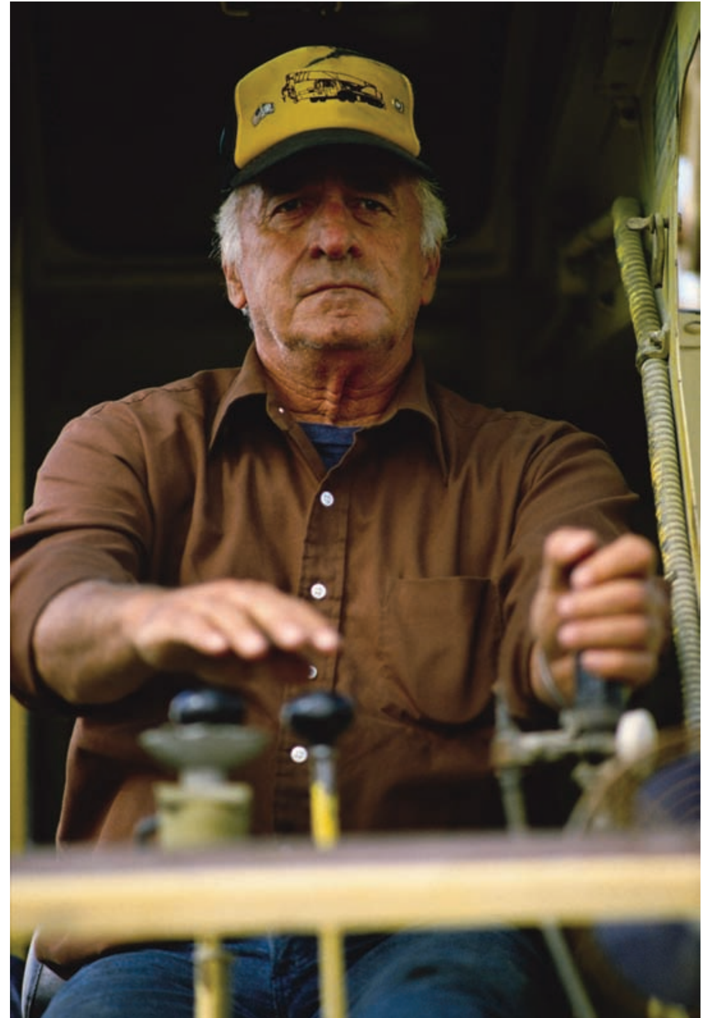


Many contractors like the idea of owning equipment because they can deduct the related depreciation, insurance, repairs, taxes and interest, which lowers their tax bills. Large down payments, however, can strain your resources. Also consider what your business could do with that capital if the money were directed elsewhere.

In addition, buying means you'll have storage and transportation costs. And, you must deal with disposing of the equipment once it has outlived its usefulness.

Leasing

Many contractors lease their equipment to conserve capital. If you'd rather allocate money toward salaries or growing your company, for example, leasing offers a good alternative to buying.

Equipment leasing is essentially a loan. The lender buys and owns the equipment and then leases it at a flat monthly rate for a set number of months. At the end of the lease, you have the option to purchase the equipment, return it or lease new equipment.

Many leasing companies offer flexible payments that help contractors and other seasonal businesses manage their payments during busy months and allow no payments during slow periods. Because payments are fixed for a set period, you can knowledgeably budget into the future.

Most leases can be structured so that payments are made with operating rather than capital funds, eliminating or reducing capital budget delays. As an additional benefit, you can usually deduct monthly payments as an operating expense.

There is a downside, however. If you go the leasing route, you'll likely pay higher interest rates than what you'd pay on a bank loan to actually purchase the equipment outright.

Renting

Smaller construction firms often can't afford to own every piece of equipment they need, but they can't afford to be without them either. So a big advantage to renting

equipment is that you pay for it only when you use it. You can always return the equipment to the rental company if business slows down or if a project falls through. If you own the equipment, you're stuck with it.

Equipment rental offers many of the same benefits as leasing, with three distinguishing differences:

1. Rental contract periods provide total flexibility. For example, equipment can be rented for any length of time, from one day to as long as one year.
2. Rental equipment includes maintenance provisions.
3. If you don't like the equipment, return it; you're not locked into a long-term commitment.

Renting also gives you convenient access to the newest and best equipment. Rental fleets upgrade regularly, allowing you to avoid technological obsolescence. They also provide specialized mechanics who maintain the fleet so that it's in top condition. A larger rental company should be able to dispatch a mechanic to your project site quickly or, if necessary, deliver a replacement piece of equipment.

Finally, renting simplifies your budgeting, bookkeeping and accounting because it greatly reduces paperwork and administrative requirements. There's only one invoice — and one cost — to account for. And remember, rental expenses may be deducted as a business expense.

Review your options

Take the time to fully investigate and evaluate all your equipment options. A financial professional can help you weigh the cost and tax benefits associated with each option, as well as helping you establish and manage budgets. Take your time; it could make a big difference on your bottom line.

Cash counts: It pays to know the flow

Cash flow is the lifeblood of any organization, but the unique aspects and complex nature of the construction industry — such as projects that span several years and seasonal slowdowns — make cash flow an even more critical issue for contractors.

A cash-flow forecast can show you if and when you'll run out of cash, allowing you to cope with seasonal fluctuations in business, strikes or other unexpected circumstances that could create a money crunch. A forecast can also help demonstrate to creditors why and when an increased line of credit may be necessary.

Look at the trends

It's impossible to predict exactly what profits current and future projects will generate and when owners will pay you. But you can generate a cash-flow forecast by focusing on specific patterns and trends, such as the following:

Current jobs. Look at these and their respective payment schedules on a percentage-of-completion basis. Though you may have already incurred 50% of a job's total costs (thus recognizing 50% of your expected contract revenues), you may not yet be able to bill for the corresponding contract revenues. So, you should correlate cash receipts with billings, not revenue recognition.

Anticipated billings. These will help you determine the expected amount of cash receipts you'll receive, as well as the basis for projected cash disbursements. Some contracts are easier to project future billings on than others. For example, one contract may stipulate

that billings must occur in five equal installments over the contract's duration at a fixed price. But another may have less certain billing arrangements, such as on completion of a specified project phase. And, of course, unavoidable circumstances (bad weather, supplier delays) often arise and throw jobs off schedule. Estimate billings on these contracts conservatively based on historical trends.

Accounts receivable. Look for collection patterns to determine how long after billing you'll actually receive the cash. Develop some cash receipt assumptions, including a collections model that presumes, for example, that in any one month you'll collect 10% of that month's billings, 65% in the next month, 15% in the third month and 10% in the fourth (usually retainage). Use your company's own collection pattern to develop this model.

Cash disbursements. These generally fall into three major categories: 1) job cost payments (including inventory, supplies and other job-related expenses), 2) administrative expenses (such as salaries and rent) and 3) debt service payments (including interest). Using this information, develop a model that allows your current projected billings to consistently cover your variable expenses from month to month. But commit to only the purchase and operating expenses your incoming cash will support.

Staying afloat with other people's money

When the flow gets slow, resourceful contractors know how to legally use more cash than is actually sitting in their bank accounts. You do this every time you buy something on credit. That's why it's critical to establish and nurture strong vendor relationships — so you can obtain the best possible terms. Strive to achieve 45- to 60-day terms with most of them.

Also look to your friendly banker — a lender's terms allow you to use other people's money to support your construction business. Of course, this option comes with the expense of interest, but it may be an effective way to expand your existing operations while maintaining acceptable payment terms with other creditors.

Once you've completed the cash-flow forecast, you need to establish a long-term, proactive plan for maintaining positive cash flow. The plan should anticipate problems and lay out the steps you'll take to manage shortages most effectively.

Make sure you collect what's yours

A healthy cash flow ultimately depends on your customers. Consider the following strategies to encourage timely payments:

- Negotiate contracts where you can bill earlier for greater amounts,
- Front-load billing schedules to provide strong billings in early project stages, and
- Accelerate payment options, such as wire transfers or electronic checking.

Finally, make sure your billing clerks aren't guilty of slowing down the collection process. Along with following up regularly on unpaid bills, they should know the due dates for pay applications and follow proper procedures, such as attaching backup documents like certified payrolls and lien releases.

More than numbers

The most successful contractors may be able to squeeze the last nickel, but they also know exactly how much money is coming into their businesses and how much is going out. Make sure you understand the ebbs of your cash flow. It can mean the difference between floundering in a sea of debt and swimming in profit.

Multistate taxation

Skirting filing requirements can cost you big bucks

If you're like many contractors, you probably perform work in more than one state. "Nexus," or physical contacts in a state, determines whether you must pay or collect state taxes (such as income, sales and use) in those states. And, if you provide construction services, maintain an office or employ workers in a given state, it's highly likely you'll be required to pay state taxes.

Nexus is defined on a state-by-state basis, but, generally, even minimal activity will trigger a filing requirement.

How much will you have to pay?

Taxation depends on your business entity and state tax rates. A few states don't impose state income taxes; others have relatively low rates and some have relatively high rates. You may be subject to taxes on income, capital or gross receipts, but almost all have a minimum tax required. Do your homework to find out how the states in which you do business tax your activity.

Keep in mind that you may be eligible for the tax incentives, exemptions and credits that state governments sometimes offer businesses to reduce their tax burdens. Small to midsize companies often qualify for such benefits, but may overlook them.

What if you're operating at a loss?

Although you might not have any state income tax liability, your sales and use tax exposure continues to accrue if you fail to collect and remit these taxes. You generally owe sales or use tax for the cost of materials, supplies, equipment and services purchased, rented or used on a job. In addition, if you perform repair or maintenance services, you may have to charge sales tax on the labor.

Contractors may owe sales or use tax on material costs even when contracted by agencies or organizations that qualify for sales or use tax exemption. Contractors are not resellers; they are considered users and consumers of materials purchased for a job. Also consider tax bonding statutes. Some states require nonresident contractors to post a tax bond before starting a job.

What about government and public projects?

Some contractors believe they aren't subject to state taxes if they're working on a government or public project. While you may be exempt from some taxes, such as sales tax, the fact remains that, if you have people working for you in that state, generally you'll be subject to income and withholding taxes. Doing work for a tax-exempt entity doesn't necessarily relieve you of a tax burden.

If you ignore it, will it go away?

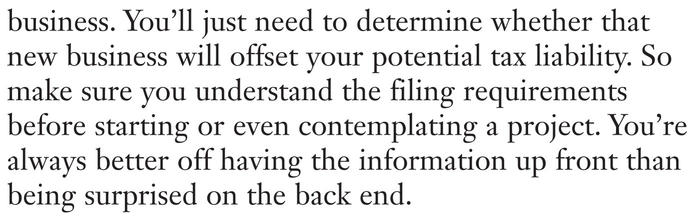
Contractors who don't comply with state filing requirements are at high risk of getting caught. Faced with mounting budget shortfalls, cash-strapped states are aggressively going after companies that try to skirt their obligations. Finding delinquent filers is often as simple as matching payroll, sales or property tax forms against required income tax filings.

Moreover, many states have opened audit offices in other states, established information exchange agreements with each other and with the federal government, and refined their strategies for pursuing companies they believe aren't in compliance. If auditors from one state show up at your door, those from other states could soon follow.

If you ignore your state tax liability, you'll be subject to back taxes, interest and penalties. The amount will compound over time, taking a big chunk out of your resources.

Is it just the cost of doing business?

State taxes are simply another cost of doing business. In the long run, it may pay off for you to expand outside your home state by bringing in a wealth of new



business. You'll just need to determine whether that new business will offset your potential tax liability. So make sure you understand the filing requirements before starting or even contemplating a project. You're always better off having the information up front than being surprised on the back end.

Seek the help of a tax specialist who understands each state's rules. He or she can help you determine whether you are in compliance with state income tax filing requirements in the states for which nexus potentially exists.

Value engineering adds value to construction projects

A strong design and top-notch project team are key drivers in a successful construction project. But how do you make a great project even better? The answer lies in value engineering — a method for adding value, increasing quality and reducing costs at the same time.

Value engineering is an organized form of brainstorming that focuses on finding ways to save money without sacrificing quality and safety or reducing a project's scope. It can mean using different types of building materials — perhaps using a pre-engineered steel frame rather than building a wood frame on-site — and different construction methods, such as design-build. When used successfully, it can produce savings of 30% or more, according to SAVE International, a society for the promotion of value engineering.

Formal value engineering

Traditional value engineering usually involves the formation of a project management team that:

1. **Gathers information.** This includes studying project documents and reviewing costs.
2. **Generates alternatives.** The team brainstorms about what can be done to enhance value and lower costs.
3. **Analyzes the alternatives.** Ideas that aren't feasible are eliminated.
4. **Selects the best alternative.** This means putting the proposal to paper and selling the idea.

Contractors who participate in the process may qualify for incentives, such as a share of the cost savings, if the value engineering proposal is adopted.

A value engineering alternative

A less systematic process is making a value engineering change proposal (VECP), which involves a contractor proposing a change that is likely to improve a project's value.

For example, say you're working on a project to improve two adjacent bridges. The original design had separate detours for the bridges, but you suggest the detours be combined by connecting a temporary concrete barrier. This VECP reduces roadside obstructions and eliminates the need for four expensive crash cushions.

If an owner accepts your proposed change, you and the owner split the resulting construction cost savings. Using VECPs can significantly improve your financial position.

A golden key

Instead of being stymied by the parameters of a job, seek innovative value-creating recommendations that can save bottom line costs and improve profits. The earlier in a project that value engineering is incorporated, the more likely it is that you'll see optimum results for all involved.

Contractor's toolbox

Build bonding capacity with tried and true methods

Is there enough bonding capacity to go around? For most contractors, the answer is "yes," but bonding companies are very careful in taking on bond business. How, then, can you convince sureties you are worthy of bonding?

A changing environment

In the flush surety market of the mid- and late-1990s, contractors could obtain surety bonds without much difficulty. Subsequent years of record losses and the aftereffects of the Sept. 11 attacks, however, took the sizzle out of bonding. As a result, sureties clamped down on their underwriting policies, reduced bonding capacities and became more selective about the contractors to whom they offered bonds.

So where does that leave you today? Most bonding companies are publicly traded and, therefore, must produce positive results for shareholders. Their underwriting reflects this responsibility. As a result, sureties want to know that your company is well managed, profitable and trustworthy. Contractors that fit this profile have a wider window of opportunity to either obtain or increase their bonding capacity.

Under the microscope

You must give sureties accurate and timely financial information to help them develop a solid, well-rounded understanding of your business. Expect to provide extensive documentation in such areas as company history, work records and work in progress, along with budgets and financial statements that go back as far as five years.

Bonding companies may also want to see resumés of your key managers, plans that show how your organization will avoid or minimize unexpected disruptions (such as strikes or seasonal fluctuations) and other documentation that supports the longevity of your construction firm. Don't be surprised if sureties also interview subcontractors, suppliers and current and former customers about their dealings with you.

Winning strategies

There are strategies you can follow to give sureties the best possible view of your company. Try the following back-to-basics suggestions to help get the bonding capacity you need:

Maximize year end cash. Showing substantial cash balance in your financials can impress an underwriter. To this end, consider deferring payment on accounts payable or speeding billings for accounts receivable to improve year end cash balances.

Emphasize working capital. Bonding agents particularly look for working capital, which is current assets minus current liabilities. As a general rule, sureties believe that contractors with higher levels of working capital have a better chance of successfully completing their contracts.

Demonstrate the ability to estimate accurately. Sureties will require a schedule of your contracts in progress and completed contracts. Any projects from a previous year that were estimated to generate large profits but ended up in the current year with a reduced profit will be questioned.

Bonding benefits

Better bonding capacity allows you to pursue larger, higher-paying jobs. Bonding can also enhance your borrowing capacity because creditors know that a qualified surety is reviewing your financial statements and company history. When these rewards are up for grabs, you can't afford to overlook the fundamentals.

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