



# Blueprint

Building Profits for Construction & Real Estate Companies

## Beefing up your balance sheet How to strengthen your financial position in uncertain times

by Jerry Henderson, Bowling Green

Depending on new commercial construction continues to slump, and competition for work is fierce.

Economic indicators point to an upturn one month and a downturn the next.

It's critical in uncertain times to improve your competitive edge, but how? One way is to adopt a strategy for strengthening your balance sheet.

### Working capital strategies

Improved working capital management allows you to:

- ✓ Increase your bonding ability
- ✓ Shorten your cash collection cycle
- ✓ Increase project financing

Competitive advantages generated through improved working capital management may determine whether or not you have the ability to get the work.

### Retainage management -

As a general contractor, you may be able to turn retainage into cash more quickly by negotiating a sliding scale on retainage that decreases the percentage retained on billings as the job progresses.



### Progress billing management strategies -

Progress billing management is another area of opportunity, and its message is simple: do all you can to collect your receivables as quickly as possible.

For example, a contractor issues a \$50,000 progress billing that includes \$1,000 worth of unapproved work. Charges for the unapproved work of \$1,000 often will delay the payment of \$49,000 on work that was approved.

In situations like this, bill each amount under a separate invoice. Implement procedures that diminish disputed amounts. Be sure billings are timely and customers understand your terms for payment.

Remember, some people aren't willing to pay *more* for higher quality, but they almost always pay *more quickly* for it. A contractor or subcontractor with an outstanding reputation almost always commands faster payment than a lesser competitor.

### Financing strategies -

Contractors often draw on credit lines to cover equipment purchases, especially used equipment bought at auction. The need for quick payment may require an initial draw, but equipment purchases should be refinanced soon after under a term loan.



Having an established relationship with your lender is critical to having the financing that is right for your business and is available at the right time. Equipment purchases shouldn't consume a disproportionate share of working capital. Keep your lender informed so your debt can be restructured more quickly.

### Net-worth strategies

Strong net worth is viewed favorably by both lenders and bonding companies. When net worth is improved, you reap several of the same benefits as when working capital is improved.

**Owner lending -** In many cases, an owner may draw excess funds from the company only to lend them back when times are lean. If an owner has to make such a loan to the business, consider it as an investment in the business, *i.e.*, as equity instead of a loan.

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## Welcome to Blueprint

Welcome to the inaugural issue of **Blueprint**, a newsletter designed to address revenue enhancement, cost management, strategic planning, human resources, technology, tax and accounting concerns of construction and real estate companies.

**Blueprint** will be an important link to the resources of BKD. We provide solutions for success to nearly 4,000 contractors and real estate-related clients.

While **Blueprint** will play an important role in our ongoing communications, the members of our 75-person BKD construction and real estate services team are our critical link to you.

Representatives of our team are listed on page 2, and we encourage you to call them or your other BKD advisors to discuss your financial and management needs. And be sure to check out our resources on [www.bkd.com](http://www.bkd.com). □

## Inside

- ✓ Solutions for construction & real estate
- ✓ Increase cash flow with proper tax strategies
- ✓ Free money for developers

# Solutions for construction & real estate

by Jim Van Dyke, Kansas City

Whether you head a multi-state construction operation, subcontract locally, develop high rises or sell homes, today's complex business environment can be difficult to navigate.

BKD is a key business advisor to approximately 1,000 construction companies and nearly 3,000 real estate-related clients in 11 states.

Our construction clients include heavy construction, general, specialty and residential con-

tractors and subcontractors.

Our real estate clients include multifamily housing, commercial and residential developers; engineering firms; and architectural consultants.

This rich client pool, combined with the collective experience and skill of our construction and real estate consultants, provides resources not found in local firms and for a price competitive with international firms.

For more information, contact your BKD advisor or a contact from the accompanying list. □

## Beefing up your balance sheet. . .

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Your lender or bonding company will be more favorable to equity than a loan from the company's owner.

If the funds can't be committed as equity, consider signing a subordination arrangement with your lender. This will prevent the owner from taking the money out of the company until the bank debt is repaid or, in the case of surety credit, until the credit commitment expires.

**Tap into underlying value in assets** - While generally accepted accounting principles require assets be stated according to their historical cost, the underlying fair value of the assets could be quite different.

If the assets of the business are worth more than what appears on the financial statements, consider a separate appraisal. If the fair value is substantially more than the book value, lenders and bonding companies will often give

the appraised value consideration and credit you with additional net worth.

**Contribute property to the business** - Sometimes, personal investments outside the business can improve a company's financial position if they are included on the books. This could include unencumbered real estate investments, stocks, bonds or other similar investments.

Consider contributing such assets to the business.

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These strategies may help improve your financial position in these uncertain times. To avoid any unintended tax consequences, consult your BKD advisor first. Know how the strategy you choose will affect your tax situation.

Your BKD advisor can help you customize a strategy to beef up your balance sheet and improve your competitive advantage. □

## BKD Market Leaders

Representative construction and real estate contacts in BKD practice units.

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## Construction & real estate

### Operations management

- ✓ Business process assessment
- ✓ Information technology management
- ✓ Overhead analysis
- ✓ Human resources management
- ✓ Regulatory compliance solutions
- ✓ Dispute and litigation support
- ✓ Operations improvement consulting
- ✓ Cash management

### Financial management

- ✓ Strategic financial planning
- ✓ Mergers and acquisitions
- ✓ Business valuations
- ✓ Succession planning
- ✓ Feasibility studies and projections

### Tax strategies

- ✓ Federal and state tax strategies
- ✓ Reverse sales tax audits
- ✓ Sales and property tax reviews

# Increase cash flow with proper tax strategies

by George Gabor, Indianapolis

Meeting with your tax advisor as 2002 comes to an end may increase cash flow to your company.

Every company is different, but recent tax legislation has been favorable to taxpayers and offers some exciting tax-planning opportunities.

With corporate and individual (via S corporation pass through) tax rates at their current levels, traditional strategies for profitable companies in such an environment have been to defer income and accelerate deductions.

Less fortunate companies, those suffering losses in the current year, may need to consider a different plan of action.

Whatever your situation, you may find the following strategies helpful.

## Strategies for profitable companies

- ✓ Purchase new equipment

before year end. To stimulate capital spending and aid the economy, the *Job Creation and Worker*

*Assistance Act of 2002* created an additional first-year depreciation deduction equal to 30% of the adjusted basis of qualified property placed in service after September 10, 2001.

In addition, taxpayers can still elect to expense up to \$24,000 of the cost of property acquired in 2002. However, if this expensing is elected, the amount expensed “comes off the top” before the additional 30% first-year depreciation allowance is computed.

The taxpayer then computes regular first-year depreciation (and depreciation for future years) with reference to the adjusted basis remaining after expensing and after the additional 30% first-year allowance.

- ✓ C corporations should attempt to make the most of compen-



sation (and bonuses) to owners by using reasonable formulas to help avoid a buildup of earnings inside the corporation, which could essentially result in double taxation to the owners on tax-returned income.

- ✓ Owners of C corporations should be alert to structuring transactions that result in deductible payment to the owners, *e.g.*, rent on real or personal property, or fees (surety or bank guarantees, etc.). These payments can be made in addition to compensation (reduces payroll taxes).
- ✓ Consider corporate restructuring to reduce state income taxes.
- ✓ Consider tax-accounting methods that accelerate deductions or defer taxable income. Look for changes where the adjustment necessary to effect the change can be taken into account over one year vs. the more traditional four-year spread. This can result in an immediate and significant cash-flow saving, *e.g.*, payroll and personal property tax accruals.
- ✓ Identify and segregate the cost of personal property inherent in real property construction to accelerate depreciation deductions by using the shorter recovery periods applicable to personal property.
- ✓ Employ and compensate the owner's children over age 14 to take advantage of the children's lower tax brackets.
- ✓ Accrue and deduct profit-sharing plan contributions payable after year end but before filing tax returns.
- ✓ Write off uncollectible receivables or partially worthless debts.
- ✓ Accrue and deduct bonuses paid to nonowners.

## Strategies for unprofitable companies

- ✓ Consider electing S corporation status to take advantage of any future losses at the individual owner level. Asset values may have been negatively affected by losses, which can significantly lower the potential built-in gains tax applicable to S corporation elections.
- ✓ Make the most of the net operating loss (NOL) and recover previously paid taxes if marginal rates over the past five years were greater than the anticipated future year rates, or conversely, reduce the NOL if future tax savings will be greater.
- ✓ Where carrybacks of NOLs are unavailable or undesirable:
  - ▲ Elect longer depreciation recovery periods or less accelerated methods for current year asset additions or elect not to use the 30% “up front” bonus depreciation allowed.
  - ▲ Contractors on the percentage-completion method should try accelerating delivery and installation of materials or performance of subcontractor work on profitable jobs.
  - ▲ Defer payments under discretionary compensation plans. Also consider establishing some deferred compensation plans for key employees.
  - ▲ Accelerate the settlement of insurance or damage claims.

To be effective, most of these tax strategies must be in effect before your company's fiscal year end. To help tailor your tax strategies and learn how these legislated opportunities can increase your company's cash flow contact your BKD tax advisor. □

## solutions from BKD

- ✓ Unemployment and payroll tax reviews
- ✓ State and local incentive and inducement programs
- ✓ Real estate cost segregation studies
- ✓ Tax-deferred exchanges
- ✓ Choice-of-entity planning

- ✓ Job cost accounting
- ✓ Key performance indicators and monitoring
- ✓ Lease vs. buy analysis
- ✓ Accounting methods

### WealthPlan

- ✓ Investment advice
- ✓ Insurance solutions
- ✓ Income tax planning
- ✓ Retirement services
- ✓ Estate planning
- ✓ Personal wealth strategies

### Financial assurance

- ✓ Audits, reviews and compilations
- ✓ Outsourcing
- ✓ Budgets and forecasts

# Free money for developers. . . where's the catch?

by Kevin Pahud, Indianapolis

Government tax incentives are difficult to qualify for, much less receive. The proper tax treatment may be the key to unlocking them.

Incentives that specifically support real estate development are some of the most lucrative. All too often, developers, particularly developers of urban projects, fail to take advantage of the incentives available from local sources.

- ✓ Cash funding arises from a bond issuance, often backed by a letter of credit
- ✓ Bond repayment occurs as a result of increased property and sales taxes

Ordinary income is created based on the fair value of the incentive(s) received. Or is it?

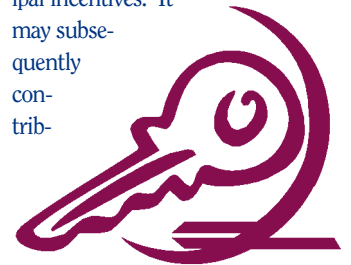
While meeting the criteria for any of the above is challenging, what may be of greater importance is—you guessed it—the proper tax treatment.

'real' benefit is net of associated income taxes, right?" *Wrong!*

Proper structuring affords a developer the opportunity to exclude the fair value of the incentives received from ordinary income. This treatment hinges on the developer's ability to exclude the incentives under the special tax treatment afforded capital contributions, specifically nonshareholder capital contributions.

Here's the catch. In its infinite wisdom, the Internal Revenue

Your BKD tax advisor can help structure the project such that a corporate entity negotiates and receives the municipal incentives. It may subsequently contrib-



## *Incentives that specifically support real estate development are some of the most lucrative.*

These incentives typically are location inducements or other municipal incentives. Municipalities structure their programs differently, but most have a few qualifying criteria in common:

- ✓ Eligible projects must have some perceived "public" benefit or value
- ✓ Funding is typically in the form of improved or unimproved land or cash

### **If it looks too good to be true . . .**

"There's no way the federal government is going to allow the city to write me a check for several millions of dollars to pay for this parking garage and not want its fair share. After all, real economic benefit has transferred to me in the form of a parcel of land or cash. It only makes sense that my

Service has afforded nonshareholder capital contribution treatment only to **corporations**. There is absolutely no parallel provision within the partnership tax environment, and because most real estate developments are structured as partnerships or limited liability companies for tax purposes, it is imperative proper planning take place.

ute the property or cash to a related partnership or retain ownership itself depending on the asset's characteristics and the objectives of the owners. The key is that these discussions take place in the project's infancy.

Yes, there are other criteria that must be met to achieve the desired tax-free result. But most often, the legal structure is the single factor preventing developers from "having their cake and eating it too" when it comes to municipal incentives.

Contact your BKD tax advisor for guidance on your next project. □

**How to Reach  
BKD**

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International 

For a complete list of our offices and subsidiaries and their contact information, go to [bkd.com](http://bkd.com) or call Director of Communications at 417 831-7283.

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