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# Construction

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A NEWSLETTER FOR THE CONSTRUCTION INDUSTRY

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## When Should You Say No? Eight Red Flags for Contractors

The Greek general Pyrrhus once won a battle that decimated his forces so badly he said "One more such victory and all is lost." The general would understand contractors who survive a particularly harrowing job, and hope never to win another "Pyrrhic victory."



When nightmare jobs are examined to determine what went wrong, a few factors come up over and over again. All of them are worth careful consideration before taking on work, especially in today's uncertain economic climate.

Here are eight red flags that signal danger — and possibly a job to avoid.

**1. Questionable finances** — Due diligence is always important, but even more so in a softening economy. Subcontractors should confirm the GC's financial capacities, and both should verify the owner's status. They should look at credit, too, because there are two kinds: a loan in place, and a loan somebody is hoping for. Contractors should find out which kind the project has.

Most basic facts about a company's standing can be discovered with a bit of research. Banks, industry associations, public Web sites and other people in the business can provide confirmation and information about different aspects of financial health.

**2. Unfamiliar work** — Two GC partners had built their company on commercial and light industrial projects. Then they were asked to bid on a racquetball complex. Much of the job would be routine, they had a great set of subs, the margins were impressive and the client was strong and stable.

But what about the floors? The GC had contracted many miles of floors, but not this kind, and the partners could imagine them buckling. After talking it through with associates and advisors, they offered to review the job — and then recommended another GC better suited to the project.

**3. Unfamiliar terrain** — Some problems that are manageable on home territory loom larger far away. Contractors often find supplies hard to line up, different regulations in force or labor in short supply.



When an apartment market boomed, the owners of a roofing company two states over wanted a piece of it. They got it — and found a labor market dry as a bone. What were their choices? They could scare up labor and take a major scalping on rates. They could pay travel expenses for their own local crews. Or they could produce no workers and be sued for breach of contract. As it turned out, they did a little of each. It was a job they could have done without.

**4. Too many demands** — Does an owner harbor unrealistic expectations about budgets, performance goals or schedules? Does he want to move forward anyway? Possibly the most dangerous words in construction are “We’ll work it out as we go.”

Does the client insist on hiring friends or relatives for certain jobs, rather than letting a GC organize its own reliable subs? When the client’s brother-in-law supplies and installs windows that leak, you can be sure the GC will get a share of the problem. Difficult clients come in many varieties, but good clients are all alike in one way: They respect the conventions of business, and don’t mind agreeing to them.

**5. Uncertain relationships** — If you’re not comfortable with the client or the GC, figure out why. Discomfort might stem from something undefined, like bad chemistry. Is that likely to improve over the course of the job, or get worse? However vague, uneasiness might be a warning about your lack of confidence in the team.

Contractors also develop their own rules based on experience. One Southeastern industrial builder, for example, is willing to work for new and less established clients — but not for those who want a wet bar in the office.

**6. Questions about supplier reliability** — General contractors should be diligent about their subs as well.

The GC who has worked with three concrete companies for years, and bids them against each other, is in the strongest position.

But every GC must bring on new subcontractors now and then, and when that happens the GC should do its own investigation to turn up outstanding liens, OSHA problems, a bad show-up reputation or other problems.

**7. The Big Job** — A paver’s first Big Job brought slower paydays and ballooning overhead. It had figured costs for labor and material and a few details like union dues, but had underestimated equipment rental, travel and the need for a stronger back office. The paver also had to hire new estimating talent in order to get the next Big Job.

Eventually some cash came in and the paver came up for air. But by then it was starting the second job, barely making payrolls with cash from the first. It was entering the second quarter behind and besieged. Don’t try to start too quickly. You’ll end up paying for your impatience.

**8. Becoming a bank** — In addition to his cash problems, the contractor in the previous example was floating his client a large, interest-free loan.

That can also happen when one contractor takes over from another. Without a full understanding of the job’s status — clear WIP reports and billings, especially prebillings — the new contractor might be entering a long period without money coming in. Plenty will go out, however, and that’s the same as a free loan to the client.

### Don’t Ignore Red Flags

The coming months will see ebbs and flows in the amount of work available in different trades and regions. When work slows down, contractors are sometimes tempted to overlook red flags, take on a job and hope for the best.

But it’s precisely in these times that alarms are most important. Every problem isn’t a signal to decline, of course, but the presence of any of these should be cause for close analysis before you commit to a contract. ■

*For more information call Joel Dziedzic at 630-545-4508.*

## Possible Dealbreakers, Summed Up

- If you build it, will they pay? Weak partners and shaky financing are the biggest warning signs.
- Unfamiliar work can break your teeth, so think long before you bite.
- Don’t know the territory? The Music Man faked it, but contractors should proceed with caution.
- Be ready to walk away from high-maintenance customers.
- A bad feeling usually has a basis in reality. Listen to your instincts.
- One sub’s failure can ruin a job. Know your supply chain.
- Bigger isn’t necessarily better. Too-rapid growth can destroy a company.
- If you’re financing the job, you’re losing money.



# Construction Briefs

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## Prepare for Capital Gains and Dividend Tax Hikes

An unprecedented period of lowered tax rates on long-term capital gains and corporate dividends will likely come to an end soon.

The maximum capital gains tax rate has declined sharply since the 28 percent level of the 1980s. In 2003 the Jobs and Growth Tax Relief Reconciliation Act reduced it to 15 percent, and a 2005 act extended that rate's "sunset" through 2010.

The outcome of the November elections could change matters, however. Sen. Obama has declared for a reversion to the 20 percent rate. Sen. McCain favors lower taxes overall, but should he win and govern alongside a Democratic Congress, he will face certain pressure for an increase.

Actual figures and effective dates will emerge only after legislative give-and-take under a new administration.

It's hard to gauge the impact of the lower rates on the national economy, or to predict the effects of a reversion to 20 percent. But wherever the new rate falls, taxpayers with long-term capital gains and dividends will undoubtedly face a bigger tax bite within a couple of years.

Given the uncertainties of the election year, prudent tax planning should proceed on the basis of the current law. But now is also good time for investors to look ahead at their capital-gains strategies.

Sometime before the end of 2010, and possibly sooner, contractors with non-liquid assets — like a family-owned construction business or real estate — may find they can save significantly on taxes by diversifying or making succession-plan moves. Planning and negotiations should begin soon. ■

*The coming changes in capital gains tax rates will be complex, but our firm can help you navigate them profitably and structure the transactions to take advantage of the current lower tax rate.*

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