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To Clients and Friends of the Firm,

forget Joe the Plumber's taxes . . .

Contractors Should Focus on Survival, then Economic Stimulus

"If you win, will my taxes go up?" Joe the Plumber's question to Barack Obama captured the American imagination, and it rang particularly true in the construction industry. Here was one of us on the front lines, debating tax policy with the presidential frontrunner.

And to be fair, Joe asked a great question. In the weeks that followed, several newspapers analyzed tax prospects for owners of contracting companies like the one Joe hoped to buy, and found those contractors would indeed have faced higher taxes under Obama's platform as it then stood. Many other contractors would have paid more too: Obama and other Democratic leaders had called for a wide range of tax increases (income, payroll, capital gains, dividends, estates) and limits on deductions and incentives for businesses.

But that was then, and this is now. While tax increases on higher incomes are still likely down the road, they appear to be off the table for now. In fact, new tax reductions and incentives, including for businesses, are a major part of Obama's economic stimulus proposals thus far. So is a new pledge to leave the Bush income tax cuts undisturbed (they are set to expire in 2010).

Construction's long recession

The trigger for Obama's reversal, of course, is the accelerating economic crisis. The financial collapse was well underway during Joe the Plumber's 15 minutes of fame, but since then the economy has continued its downward spiral with more bank failures, stock market panics, threats of automotive bankruptcies and more than half a million layoffs.

Still, as every contractor knows, even then Joe was already facing a bigger problem than taxes.

Before Joe, and before the Wall Street meltdown, the United States was already ten months into a recession — led by a depression in the housing industry — and construction contractors were taking the brunt of the hit. In that situation, higher taxes were becoming less a threat to contractors than the prospect of a sharp drop in taxable income.

Now, as the economy has declined further, and with backlogs declining, most contractors don't really know what the next year or two holds. To some, just breaking even will be a victory.

In difficult times . . .

How can you tighten your ship, weather the storm and sail intact into the recovery?

That recovery may come sooner than you think, as the U.S. government implements stimulus programs for which spending will approach or exceed a trillion dollars — programs in which construction contractors will quickly play a large part.

To come through the hardest times ahead, ready to take on a profitable share of the recovery, contractors today must focus their business strategy on certain basic elements. Our firm believes that these six areas are among the most important:

- **Customer acceptance.** As the economy slows and jobs are scarce, it can be tempting to take on work you might not have considered before. But now more than ever, contractors must carefully scrutinize their customers — even those they've worked with in the past. Why? Because the downturn affects everyone.

To be sure the owner can pay, see proof of financing and confirm a history of timely payments. Also size up the industry. For example, is the customer a retailer or a supplier to the auto industry? These aren't necessarily deal-breakers, but be careful not to bid into a situation where you may never collect.

Expect to see more low-margin jobs, onerous contract clauses and ornery clients. But don't go on a take-any-job campaign — it can take you straight out of business — and be wary of going too far outside your competencies or your geography.

- **King Cash.** A ready cash flow is always important but in lean times it's paramount. The day you win a contract, turn your attention — and especially your project managers' attention — to billing and collection. Be sure everyone understands billing and documentation requirements from the owner, architect or general contractor. If in the past you waited 60 days to pursue collections, move it up to 30 days. Often the squeaky wheel really does get grease. But if receivables go past 90 days, discounts may make sense.

For your own part, pay bills in installments whenever possible and never pay in advance without a solid discount. Remember that vendors face the same economy, and many of them will be more ready to deal.

- **Two budgets.** Volatility like this argues for two budgets, not one. First develop a traditional conservative budget with forecasted revenues and detailed cost structure.

Then do it again — for a “doomsday” scenario, such as in the case of failed funding on a key project. The value of this exercise is simple: Most significant cost containment measures, like layoffs, involve emotional decisions, and those are best made early in a cooler atmosphere. It’s natural to delay cutting costs and hope things will change, but it’s better to understand in advance which employees face termination if the company can’t meet its revenue targets.

- **Cost structure.** In good times it’s easy to decide an expense is necessary. But is it really? Now’s the time for owners and CFOs to sit back and openly and honestly challenge the company’s cost structure line by line. What items can be reduced or eliminated completely?

Then encourage everyone at all levels to drive out costs as well. Make a point of publicly congratulating and rewarding employees who find such savings, possibly with a bonus. Start at the top, and be alert to appearances. An S-corporation shareholder can take a 25% pay cut without changing his ultimate take-home profits. However, the message sent that the owner is taking a pay cut can speak volumes. Further, when employees see an owner drive up in an expensive new car, fuel it on a company card and take a raft of other personal items through the company books, they become much harder to educate about the dire economic conditions we face.

- **Review labor and staffing more closely than usual.** Identify unproductive or redundant labor and inefficiencies, and see what’s not needed. Also, consider reducing or eliminating bonuses in the short run — but plan and announce such cuts in advance, so employees don’t count on the same slice they may have received in the past.
- **Leverage underused equipment.** If volume drops and you no longer have the capacity to use a piece of equipment, it might make more sense to rent — and sell an idle machine to raise cash.

Expect counter-pressure from dealers, though, both new and used: In a slow economy, they’ll offer increasingly large discounts. Coupled with huge depreciation deductions at the federal level, these discounts can make purchases difficult to resist. But new equipment that sits on your back lot is no bargain.

End of the tunnel in sight

The debates over President Obama’s proposed American Recovery and Reinvestment Plan address the economy from many angles — infrastructure needs, job creation, credit thaw, tax relief, environmental opportunities, and so on. The result will not be entirely pleasing to anyone.

But construction contractors should focus on one thing: The vast resources of the United States government are about to be brought to bear in a great “jumpstart” of the national economy — and construction contractors will be front and center in the effort.



Obama's plan, as he explained it before his inauguration, pledges to save or create at least three million jobs, with priorities in clean energy, education, health care and infrastructure. For example, it calls for:

- constructing new fuel-efficient buildings
- modernizing 75 percent of federal buildings
- improving energy efficiency in two million homes
- building modern facilities at tens of thousands of schools
- repairing roads and bridges across the country

Other projects that have been discussed include new and upgrade construction for transit systems, airports, public housing, flood protection systems, hospitals, alternative energy projects and water-treatment plants.

However the final stimulus act is configured, it will include immediate funding for shovel-ready projects of many kinds. That means contractors who can hold on will be rewarded, and not so far down the road.

If you would like to talk about how your business can be one of the survivors, so would we. Please contact us and visit our website at www.hblip.com for further information.