

SUMMER 2021



CONSTRUCTION INDUSTRY ADVISOR

A collection of brief topics relevant to people and businesses that operate within the construction sector, brought to you by **Smith, Kesler & Co.**



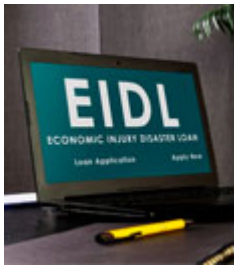
**SMITH, KESLER
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CERTIFIED PUBLIC ACCOUNTANTS
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Smith, Kesler & Company, P.A.

with offices in:

Spartanburg, SC	(864) 327-1504
Durham, NC	(919) 544-5198
Charlotte, NC	(704) 454-5214
Charleston, SC	(843) 388-1704



Many construction businesses have struggled during the pandemic. One way to obtain some helpful working capital is a COVID-19 Economic Injury Disaster Loan offered by the Small Business Administration. This article discusses the details and requirements of these loans. A sidebar warns recipients of Paycheck Protection Program loans about misuse of funds.

EIDLs offer access to working capital

If your construction business has struggled because of the COVID-19 pandemic, you may have received a forgivable Paycheck Protection Program (PPP) loan through the Small Business Administration (SBA). But if those funds have run out — or if you have expenses that a PPP loan doesn't cover — you may want to explore other funding options.

One possibility is a COVID-19 Economic Injury Disaster Loan (EIDL), which is also offered by the SBA. Unlike PPP loans, EIDLs aren't forgivable, but they allow eligible businesses to fund their working capital needs on favorable terms. And while PPP loans are no longer available, you may apply for an EIDL through the end of 2021.

Pandemic relief

The EIDL program isn't new. For years, the SBA has offered direct loans of up to \$2 million to eligible small businesses in declared disaster areas that have suffered substantial economic injury. For the purposes of these loans, “substantial economic injury” means that a business is unable to meet its obligations and pay its ordinary and necessary operating expenses.

In the early stages of the pandemic, the CARES Act established an enhanced EIDL program for small businesses affected by COVID-19 — essentially declaring the entire country a disaster area — offering lower interest rates, longer repayment terms and a streamlined application process.

Loan details

EIDLs related to the pandemic are available to small businesses (as defined by SBA guidelines) that have suffered substantial economic injury because of COVID-19 and are unable to obtain credit elsewhere.

Initially, the SBA allowed eligible companies to borrow up to \$150,000 to fund up to six months of working capital needs. However, as of April 6, 2021, they can borrow up to \$500,000 to fund up to 24 months of working capital needs. Businesses that applied for or received an EIDL before that date may request additional funding up to the new limit. As of this writing, the SBA was developing a plan to increase the maximum loan amount to the statutory limit of \$2 million.

The interest rate on these loans is 3.75% and the maximum term is 30 years (depending on the borrower's ability to repay). Collateral is required for loans over \$25,000, but the CARES Act waived personal guarantee requirements for loans up to \$200,000. Ordinarily, payments on

EIDLs must begin in 12 months, but the SBA extended this deferral period to 18 months for loans made in 2021. (Note that interest accrues during the deferral period.)

Use of funds

EIDL funds may be used for a broad range of working capital needs — including payroll, employee benefits, accounts payable, utilities, debt payments and other operating expenses. In contrast, at least 60% of a PPP loan must be used for payroll, with the remainder used for other specified operating expenses.

Certain uses of EIDL funds aren't permitted, including:

- Payment of dividends or bonuses,
- Disbursements to owners, unless directly related to the performance of services,
- Repayment of stockholder/principal loans (with certain disaster-related exceptions),
- Expansion of facilities or acquisition of fixed assets,
- Repairing or replacing physical damages,
- Refinancing of long-term debt, and
- Repaying all or part of a direct federal debt (including other SBA loans) other than an IRS obligation.

Keep in mind that, though the same business can obtain a PPP loan and an EIDL, the loans cannot be used to fund the same costs.

How to apply

The easiest way to apply for an EIDL is online at <https://covid19relief.sba.gov>. The initial application form gathers basic information. This includes gross revenues and cost of goods sold for the 12-month period ending January 31, 2020, general and ownership details about your company, and other financial and personal data.

You'll also need to furnish the most recent tax returns for your business, a schedule of liabilities listing fixed debts, and tax information authorizations and personal financial statements for certain owners. As of this writing, the average processing time for EIDL applications is 17 days, according to the SBA.

Evaluate your options

If your construction business is short on working capital, an EIDL is worth a look. But be sure to investigate and evaluate all your funding options. Although EIDLs offer attractive terms, there may also be disadvantages, such as restrictions on use of the funds. Your CPA can help you identify and evaluate optimal funding sources.

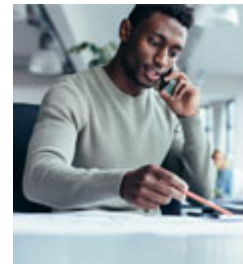
Sidebar: Handle PPP loans with care

If you received a Paycheck Protection Program (PPP) loan, misuse of the funds can result in loss of eligibility for loan forgiveness or even fraud charges. Although many PPP fraud cases involve fraudulent applications — for example, for businesses that don't exist or have no employees —

legitimate applications can also lead to fraud accusations if the proceeds are misused. Although federal authorities are focusing their efforts on intentional fraud, unintentional fraud can lead to civil penalties or even criminal charges.

PPP loan recipients must use at least 60% of the funds for payroll, with the remainder applied toward mortgage, rent, utilities and certain other specified operating expenses. Failure to use at least 60% of the loan proceeds for payroll, or use of the funds for impermissible expenses, can have devastating consequences — even if inadvertent. To mitigate the risk, it's a good idea to segregate PPP loan proceeds in a separate bank account and carefully document all transactions involving that account. Demonstrating a good faith effort to comply with program requirements can be your best defense.

For any construction business owner, an enduring question is: Just how valuable is my company? The answer is variable because the value of any business rises and falls depending on a number of factors. This article explains why valuations are important for contractors and explores three critical parts of the appraisal process.



Place a high value on a business valuation

If you own or co-own a construction business, it's likely the most valuable asset in your possession. But the question is and will remain throughout your tenure as an owner: Just how valuable is it?

The answer is variable because, as you're likely aware, the value of a company rises and falls depending on a number of factors — not the least of which is the national economy and the state of your local construction market as it rebounds from the COVID-19 pandemic. For this reason, it's important that any business owner, including a contractor, place a high value on valuation.

More than M&A

Perhaps the most common purpose of a valuation is a prospective ownership transfer, such as a merger or acquisition. Yet strategic investments — such as expanding into a new construction specialty or buying a large piece (or multiple pieces) of new equipment — can also greatly benefit from an accurate appraisal. As growth opportunities arise, construction business owners have only limited resources to pursue chosen strategies. A valuation can help plot the most likely route to success.

But hold on, you might say, why not simply rely on our tried-and-true projected financial statements for strategic planning? One reason is that projections ignore the time value of money because, by definition, they describe what's going to happen given a set of circumstances. Thus, it can be difficult to compare detailed projections against other investments under consideration.

Valuators, however, can convert your financial statement projections into cash flow projections and then incorporate the time value of money into your decision making. For instance, in a net present value (NPV) analysis, an appraiser projects each alternative investment's expected cash flows. Then he or she discounts each period's projected cash flow to its present value, using a discount rate proportionate to its risk.

If the sum of these present values — the NPV — is greater than zero, the investment is likely worthwhile. When comparing alternatives, a higher NPV is generally better.

Critical parts of the process

Understandably, many contractors don't know what to expect from a valuation. To simplify matters, you can break down the appraisal process into three critical parts.

First, there's the purpose. This could be as clear-cut as an impending sale, of course. But perhaps an owner is divorcing his or her spouse and needs to determine the value of the business interest that's includable in the marital estate.

In other cases, an appraisal may be driven by, as mentioned, strategic planning. Have I grown the business enough to cash out now? Or how much further could we grow based on our current estimated value? The valuation's purpose strongly affects how an appraiser will proceed.

Second is something called the standard of value. Generally, business valuations are based on fair market value — the price at which property would change hands in a hypothetical transaction involving informed buyers and sellers not under duress to buy or sell. But some assignments call for a different standard of value.

For example, say you're contemplating selling to a competitor. In this case, you might be best off getting an appraisal for the "strategic value" of your construction company — that is, the value to a particular investor, including buyer-specific synergies.

Third is the basis of value. Private business interests typically are designated as either "controlling" or "minority" (nonmarketable). In other words, do you truly control your business or are you a noncontrolling owner?

Defining the appropriate basis of value isn't always straightforward. Suppose a company is split equally between two partners. Because each owner has some control, stalemates could impair decision making. An appraiser will need to definitively establish basis of value when selecting a valuation methodology and applying valuation discounts.

The right expertise

As you can see, valuation is hardly a simple process. But it's typically an insightful one when performed by a professional appraiser with thorough knowledge and experience in the construction industry. Your CPA can also provide helpful support.



Contractors shouldn't assume that their risk of a cyberattack is low because they don't sell products on the Internet or have a major social media presence. Construction businesses are attractive targets for cybercriminals. This article explains why and discusses how to mitigate risk through a cybersecurity assessment and appropriate strategies.

Do you have a false sense of cybersecurity?

Even before the COVID-19 pandemic, construction businesses were increasingly relying on mobile devices, cloud-based applications, online collaboration, and Internet-connected vehicles and equipment. The pandemic has only accelerated the adoption of these technologies. As the number of entry points into your company's network increases, so does your cybersecurity risk.

Fight complacency

Many of the most infamous data breaches have involved large retailers or financial institutions. However, recent headlines have involved cyberattacks on other types of businesses — including construction companies.

Contractors are attractive targets for cybercriminals, not only because of the mobile nature of their systems, but also because of the many ways a cyberattack can do serious damage. Examples include:

- Disrupting or delaying projects with a ransomware or malware attack,
- Disclosing confidential bid information, and
- Stealing proprietary designs, blueprints, schematics or specifications.

Cybercriminals can also cause property damage or bodily injury by deleting data, altering plans or specifications, interfering with a project's security or safety systems, or tampering with vehicles or equipment.

Watch your supply chain

As we've seen recently, critical third parties in your supply chain can be victimized. Cyberattacks on these parties can interfere with your ability to obtain fuel and key materials, negatively affecting project timelines.

For example, earlier this year, a ransomware attack shut down Colonial Pipeline. The company reportedly paid a \$5 million ransom to regain control of its systems. Although the cybercriminals responsible for the attack provided a decryption program for the business to recover its data, the process was so slow that the company ended up restoring the affected systems from its own backups. Attacks like this are expected to increase.

Assess risk, deploy strategies

To better protect your company against cyberattacks, conduct a cybersecurity assessment. Doing so involves taking inventory of your hardware and software, as well as mapping your network, data flows and entry points. This includes access by employees, vendors, and collaborators such as architects or engineers.

Ultimately, you want to identify every potential vulnerability. Armed with this information, you can then implement internal controls and external protections to reduce the risk of a breach and develop an incident response plan to mitigate damages should one occur.

Strategies for preventing cyberattacks include strong passwords, dual-factor authentication to prevent unauthorized access, and software tools that monitor for and prevent intrusion. Keep mobile devices and computers current with the latest updates and security patches. Educate employees to help them identify and avoid phishing attacks and other threats. Training employees is particularly important because most cyberattacks are because of human error rather than technological failures.

Among the most effective strategies is to follow rigorous backup protocols to ensure that you can resume operations quickly in the event a cybercriminal destroys or blocks access to your data. Backup data should be encrypted, stored off-site and segregated from the systems being backed up to ensure they're accessible in the event your main network is compromised.

Be prepared

Like most construction businesses, yours likely will increasingly rely on mobile and cloud-based technologies — even after the pandemic. To protect yourself in this environment, conduct a cybersecurity assessment as mentioned. Then implement strategies for minimizing your distinctive risks and facilitating a quick recovery should an attack occur.

Sometimes an owner's actions during a construction project may disrupt a contractor's job progress. In some cases, the contractor may be able to recover damages for additional expenses incurred because of the disruption. However, as this article explains, proving the amount of such disruption damages isn't easy.



Clearing the higher bar for disruption damages

It's not unusual for a contractor to seek damages when an owner's actions delay completion of a project. The contractor may pursue a variety of increased costs flowing from the delay, such as

increased bond or insurance premiums, extra supervision costs, additional equipment or utility costs, and higher home office overhead.

In some cases, however, an owner's actions may *disrupt* a construction company's work. Although work continues and the project might even be completed on time, the contractor still suffers financial losses.

In those cases, the construction business may be able to recover damages for additional costs incurred because of the disruption. But proving the amount of such disruption damages entails clearing a higher bar than that for delay damages.

Measured mile method

Generally, disruption damages are caused by lost efficiency — that is, a reduction in the expected productivity of labor and equipment. For example, scheduling errors or delays in shipments of materials might require a contractor to perform work out of sequence, reducing its efficiency.

There are several methods of calculating disruption damages, but most courts prefer the “measured mile” method. Under this method, the contractor's cost of work during the period of disruption is compared to the cost of the same work during an unaffected period.

The measured mile method is generally considered more accurate because it compares the same work by the same contractor on the same project. Other methods involve comparing the current project to a comparable, recently completed job or comparing actual expenditures to expected costs.

Contract clause

The distinction between disruption and delay damages is particularly important when the contract contains a “no damages for delay” clause. This clause protects the owner from liability for delays, though there may be exceptions for bad faith or “active interference.”

Because of the potentially detrimental impact of “no damages for delay” clauses on the contractor, courts typically interpret them narrowly. These clauses usually don't prevent claims for disruption damages unless the contract contains specific language to that effect.

Worth the effort

If you believe that an owner's actions are affecting your productivity on a project, you'll need to be extra diligent about keeping a daily log of events with notes on incidents that affect your company's efficiency. Also, document communications with the owner and other pertinent parties, and ensure you're accurately recording project costs.

Contractors shouldn't overlook potential claims for disruption damages when an owner's actions have affected their productivity — even if completion of the project isn't delayed. Although it's rarely easy to prove such damages, the dollars recouped may be well worth the effort.

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