On-Site

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Could blockchain come to construction?

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You are patient zero

How to diagnose and cure your bidding maladies

Many people outside construction think the hardest part of the job is the labor required to build or renovate structures and infrastructure. But insiders know the toughest part is often bidding on the project itself.

No matter how strong your body of work might be historically when it comes to winning bids, any system can break down over time. The good news is that the cures to your bidding maladies lie within your construction company alone. You are patient zero!

Here are a few diagnostic questions to ask yourself and your leadership team regarding how you might become a healthier enterprise in this area.

Are we moving fast enough?

One of the easiest ways to win more bids is to submit first — before the competition does — so that your proposal becomes the standard against which others are compared. To get early leads on jobs coming down the pike, tap into your professional networks regularly and visit online construction bidding marketplaces.

When it comes to creating the bid, which admittedly takes time, there are ways to standardize and streamline the process, such as by creating templates that allow you to plug in numbers and see projected results, rather than crafting each proposal from scratch. Technology tools, such as estimating software, also can help to speed the bid process and increase accuracy.

Are we building relationships?

Keeping a detailed database of past clients and projects enables your staff to easily identify key contacts as well as find optimal projects to reference for a proposal. This can lay the groundwork for a successful bid because you'll be building on previously established relationships.

In cases where you'll be working with a new owner, take the time to research the client (assuming it's a developer or business) and look at some of their past projects to better understand their priorities. Doing so could make a key difference in helping you tailor a bid that fits the owner's style and needs.

In today's technologically based business world, it's easy to get in the habit of communicating electronically. As feasible and appropriate, set aside the time to pick up the phone and talk to decision-makers about their project expectations and why your proposal is the best solution. Face-to-face meetings are even better.

Are we setting ourselves up to win?

Ensure that you're bidding on jobs that are profitable and that you have a high chance of

winning. Avoid projects that are outside of your construction company's niche or area of expertise, or that are in locations where you simply won't have the workforce or resources to successfully fulfill requirements.

It's also a good idea to refrain from bidding against a large pool of competitors. This scenario lowers your chances of winning and may tempt you to bid too low and potentially lose money if you win the project, after all.

In fact, consistently coming in as the lowest bidder is usually a recipe for profit-margin disaster. Owners will generally pay more for value if you can clearly show them how you'll provide it. To that end, identify what you do better than anyone else — whether it's your stellar safety record, excellent customer service, unparalleled niche expertise, vast experience, or all or some of the above. Find ways to clearly communicate these advantages to owners without being too heavy-handed.

Do our estimates reflect true job costs?

If you don't have a complete understanding of costs, both direct and indirect, you could either be selling yourself short or overinflating the numbers. The former results in projects costing more than anticipated, and the latter may make the overall price less competitive when bidding. Either way, you risk losing either profit or jobs.

Naturally, project estimates should be as close to the final job costs as possible. One way to ensure accuracy is by using methods such as job costing or activity-based costing to place price tags on individual jobsite tasks or activities based on the resources each consumes (for example, materials used, equipment hours or labor hours).

Those jobsite activities then become line items that you can easily add or delete if the scope changes. Your estimators can divide the project into defined tasks/activities and add up the cost estimates of those activities for an overall project estimate.

It all begins with bid-hit ratio

A bid-hit ratio is the rate at which a construction company successfully bids on projects. For example, a 6:1 bid-hit ratio would mean that, for every six jobs you bid, you're winning one project on average. What's considered a good ratio is often subjective, because it depends on the size of your business, your specialty and the competitive level of your market. Nonetheless, knowing your bid-hit ratio can help you measure the success of your bidding process.

If you follow your bid-hit ratio over time, you may discover patterns in the types of jobs you're winning, where they're typically located, which clients are giving you a higher percentage of their work and even which competitors are consistently outbidding you. As you track these data points, you can create a breakdown using various categories — such as customer, project type, location, competitors / number of competitors and profit margin — to determine the kinds of jobs you have a high chance of winning, as well as which projects you should avoid.

Overall well-being

Just as a physician needs to ask questions to begin diagnosing a patient, you and your management team can pose these and other questions to improve the overall well-being of your bidding process. Of course, a doctor may consult specialists, and you can rely on your CPA to help you crunch the numbers that lead to better bids.

Get ready: New lease rules for GAAP-compliant companies

Does your construction company follow U.S. Generally Accepted Accounting Principles (GAAP)? If so, there's an important deadline coming up later this year that you should start thinking about right now.

For annual periods beginning after December 15, 2019, and for interim periods beginning a year later, GAAP-compliant companies must begin following the Financial Accounting Standards Board's (FASB's) new standard for accounting for leases. (The rules are already in effect for public companies; early adoption is permitted.)

Potential adjustments

Accounting Standards Update (ASU) No. 2016-02, *Leases (Topic 842)*, classifies leases into finance leases (that transfer control of assets at the end of their term) and operating leases.

Lessees must recognize operating leases on their balance sheets as a right-of-use (ROU) asset and a corresponding lease liability. This is measured initially at present value of lease payments. Also, the cost of the lease is allocated over the lease term, generally on a straight-line basis.

Your accounting for finance leases may call for adjustments. You'll generally need to recognize a ROU asset and a lease liability, initially measured at the present value of the lease payments, in your balance sheet. You'll also have to recognize interest on the lease liability separately from amortization of the ROU asset in your income statement.

Last, you must classify repayments of the principal portion of the lease liability within financing activities, and payments of interest within operating activities, in your statement of cash flows.

Lessors' perspective

If your construction company leases assets to other entities, the ASU does include some "targeted improvements" for lessors' financial statements. They're intended to align lessor accounting with both the lessee accounting model and the updated revenue recognition rules. For example, lessors may be required to recognize some lease payments received as deposit liabilities in cases where the collectability of lease payments is uncertain.

In addition, the ASU changes the definition of "initial direct costs" to include only incremental costs that wouldn't have been incurred if the lease hadn't been executed, such as commissions or payments to incentivize an existing tenant to terminate. Costs that were previously included but would have been incurred even if the lease hadn't

been obtained — for example, fixed employee salaries — are now excluded.

The new standard also requires lessors to separate nonlease components that transfer a good or service to the customer (for example, common area maintenance or utilities) from the lease components. Lessors will account for only the lease components, according to the ASU.

ASU 2018-11, *Leases (Topic 842): Targeted Improvements*, allows lessors to choose not to separate nonlease and lease components in certain circumstances. In this scenario, you'll be able to account for each separate lease component and related nonlease components as a single lease component.

Changes to lease terms

The new rules for leases could affect lease negotiations. For example, variable lease payments, such as rental payments based on the Consumer Price Index or a percentage of retail sales, aren't included when determining a lessee's lease asset and liability. For leases with such provisions, the lessor's initial base rent may be its only reportable fixed payment.

A lessor's liability for a fixed payment lease generally will be greater than the liability for a variable payment lease. So, expect that some lessors will want to negotiate more variable terms in their lease payment structures for this reason.

In addition, the ASU allows lessees to elect not to recognize assets and liabilities for leases with a term of 12 months or less. Lease terms of 12 months or less will be accounted for similar to existing guidance for operating leases today. This will potentially make shorter terms more desirable — especially for lessors with debt covenants based on liabilities.

Alternatively, these lessors may prefer finance leases because interest and amortization expenses would be excluded from their EBIDA (earnings before interest, depreciation and amortization).

Potential effect

There will also be new disclosure requirements so that users of financial statements can understand more about an entity's leasing activities. Work closely with your CPA to understand whether and how the ASU will affect you.

When to consider builder's risk insurance

In construction, there's always risk. No matter how careful an operation is, accidents happen — as well as theft, vandalism, bad weather and natural disasters. And let's not forget the potential for earth movement during construction or hitting hidden pipes and buried gas lines. The list of unforeseen incidents can get long!

While worker's compensation, liability and property insurance policies provide coverage for personal injury and certain types of property damage, they typically don't cover damage to property caused by construction. Builder's risk insurance fills that gap.

Why it's needed

Lenders nearly always require evidence of a builder's risk insurance policy before closing on

A variation of the builder's risk policy may protect against "soft costs" that could arise when projects are delayed. These may include lost sales and rental income or other revenue, additional interest on loans, administrative fees, and real estate taxes. Reimbursements for damages could be made if delays cause these financial obligations.

construction loans. Although project owners may buy these policies because they have the most to lose, contractors often must buy them.

In the most obvious instance, the contract may *require* you to purchase coverage. In other cases, owner-provided policies may not adequately cover the contractor's exposure to loss (such as stolen tools). Be sure to request and review the owner's policy before work begins — preferably while you're still negotiating — to understand what's covered and who's listed as insured.

What's covered

Builder's risk policies are designed to temporarily insure buildings and structures while they're under construction. They also may cover materials, supplies, fixtures and equipment that are on site, in transit or temporarily located at other locations.

Coverage varies by policy and project, but policies typically cover property losses caused by fire, explosion, collision by vehicles or aircraft, theft, vandalism and extreme weather (for example, wind, hail and rain). You may be able to buy extensions to cover your construction company's scaffolding and other temporary structures while they're on the jobsite.

Exclusions and costs

Extreme acts of nature, such as earthquakes and floods, and wind in coastal areas or beach zones, may not be covered by your builder's risk policy. But you may be able to buy extensions for projects vulnerable to these risks. Other standard exclusions include employee theft, normal wear and tear, acts of terrorism or war, rust and corrosion, and mechanical breakdowns. Damage resulting from faulty design, planning, workmanship and materials may also be excluded, so read a policy well before you buy it.

Because coverage varies by policy, so does the price. Generally, it's between 1% and 4% of the construction cost. In simple math, this means a policyholder may pay between $1,000 and $4,000 a year in premiums for a $100,000 project. Factors that impact where the price falls in that range include the type of construction (new vs. renovation, steel frame vs. wood), location, project duration and quality of materials.

Necessary protection

It's not a good idea to work on a project without builder's risk insurance. A comprehensive policy should cover the interests of the property owner, general contractor and subcontractors. If a project owner doesn't buy such coverage, it may be up to you to protect your assets. Keep an eye out for this situation and, if necessary, shop carefully.

Could blockchain come to construction?

I have a nephew who works in high finance. During a family gathering, he was telling me about blockchain and how it's revolutionizing the banking and financial industries. He believes it won't be long until this technology spreads to other types of businesses — even, he claims, my construction company. Is this true?

Well, the word "soon" is debatable. But it's true that construction technology experts are already discussing how blockchain might streamline document management and increase productivity, among other things.

Networked records

A blockchain is a time-stamped series of digital records or transactions (blocks) that are linked together (chained) in chronological order using cryptography. The encrypted blocks of data aren't owned by any single entity — or located on one centralized server.

Instead, the blockchain is replicated among all parties that are granted access and managed by the networked group of computers owned by those parties. Blocks can be added to the chain, but they can't be changed or removed. Any alterations would fail algorithm-based validation checks. As a result, digital information is securely distributed and tracked.

Many documents

As you know, construction projects tend to get bogged down by document-management issues. An enormous amount of job data is shared through paper or PDF documents, which are often stored in different systems and servers maintained by various entities. Distributing that documentation in real time is difficult.

Work may slow down or stall as team members wait to receive the information or approvals needed to move forward. Theoretically, blockchain would decentralize project data so drawings, change orders, inspection reports and other documents would be stored as blocks that team members could easily access.

Smart contracts

Another way to use blockchain technology is through smart contracts. The blockchain becomes a unified ledger system of jobsite tasks, and payments are tied directly to the tasks.

> *Construction technology experts are already discussing how blockchain might streamline document management and increase productivity.*

When one task is completed and inspected, the payment automatically transfers to the appropriate person or company if, for example, proof of work is submitted as a block to the chain. Each company working on a project receives its own contract (block), which is a computer program that uses rules-based code ("if/then" conditions) to set requirements and deadlines for the contractor and to trigger payments or penalties. *If* certain conditions are met (and verified via blocks submitted), *then* the transaction is recorded and payment generated.

On the way

It's safe to say your nephew is on to something. Any technology that allows critical data to be recorded and shared in real time is likely to find a place in construction eventually. Keep an eye out for blockchain.

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