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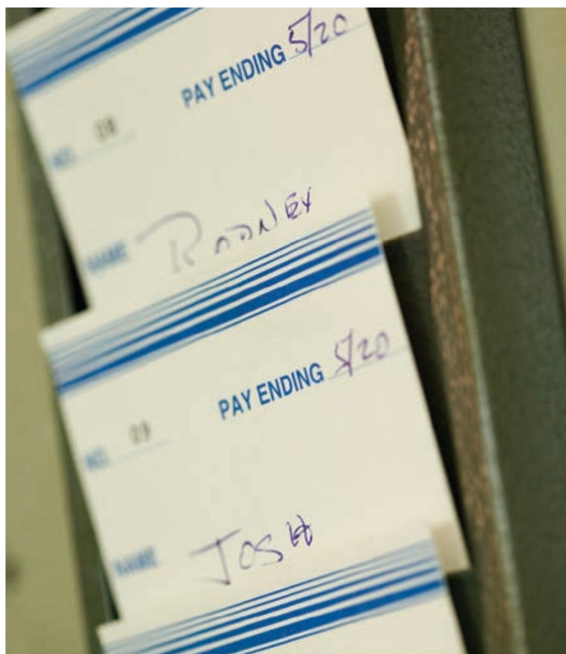
The new rule on overtime

Implications for construction companies

In May 2016, the U.S. Department of Labor (DOL) finalized its controversial "overtime rule," which doubles the minimum salary an employee must receive in order to qualify for the "white collar" exemption from overtime pay. Many construction companies employ relatively low-paid managers who will lose their exempt status under the rule, currently scheduled to take effect December 1, 2016. According to the National Association of Home Builders, approximately 100,000 construction supervisors will be eligible for overtime under the new rule.

What's changed?

The final rule increases the salary threshold for exempt executive, administrative and professional (EAP) employees from $455 per week ($23,660 per year) to $913 per week ($47,476 per year). It also increases the salary threshold for highly compensated employees (HCEs) from $100,000 per year to $134,004 per year.



In determining whether an employee is exempt, up to 10% of the salary threshold may be satisfied by *nondiscretionary* bonuses, incentive payments or commissions, provided they're paid at least quarterly. Both salary thresholds will be adjusted automatically every three years, beginning on January 1, 2020.

What hasn't changed?

The new rule doesn't change the methods of calculating overtime or (apart from the increased salary threshold) determining whether an employee is exempt from the overtime rules. Under the federal Fair Labor Standards Act (FLSA), employees generally are entitled to time-and-a-half for each hour they work in excess of 40 hours per week.

An employee qualifies for the EAP exemption if three tests are met:

1. Salary basis test. The employee receives a predetermined, fixed salary that's not subject to reduction based on variations in the quality or quantity of work.

2. Salary threshold test. The employee's salary meets or exceeds a specified amount ($913 per week as of the currently scheduled effective date of December 1, 2016).

3. Duties test. The employee's primary job duties involve the type of work associated with exempt executive, administrative or professional employees. HCEs are subject to a less stringent duties test than other workers, which makes it easier for them to qualify as EAPs.

In the construction industry, the EAP exemption generally doesn't apply to nonmanagement employees who spend a significant portion of their time performing manual labor rather than

supervising other workers, regardless of salary level.

How will it affect contractors?

Under the new rule, businesses with previously exempt employees who earn $455 or more per week but less than $913 per week will have to pay those employees time-and-a-half for overtime. If those employees regularly work more than 40 hours per week, the additional expense can be significant. There are several options for easing the burden of these new overtime obligations:

Switch previously exempt employees from salaried to hourly status. Set their hourly rates so that their overall pay, taking into account estimated overtime, is comparable to what they were earning before.

Project your compensation expense under the new rule. For employees expected to receive less than $913 per week, including overtime, consider raising their salaries to the new threshold.

Eliminate overtime. You can do this by hiring additional workers or redistributing work among existing workers.

Use independent contractors. These workers aren't subject to overtime requirements. But keep in mind that both the DOL and the IRS have been cracking down on companies that misclassify employees as independent contractors. (See "Watch out for worker misclassification" at right.)

When taking steps to mitigate the impact of the new overtime rule, don't forget to consider employee morale. For example, formerly exempt employees switched from salaried to hourly pay may view the change as a demotion or loss of status — even if their take-home pay is the same as or higher than before.

Even if you continue to pay salaries, the loss of exempt status may not sit well with some staff members. Also, employees will have to track all of their hours to be sure they're compensated for overtime and may lose some of the flexibility associated with exempt status.

Where to begin?

Start analyzing your compensation program and evaluating the potential financial impact of the overtime rule now. Whichever strategy you choose to deal with it, develop a communications strategy to inform employees of your decisions and address employee morale issues. ■

Watch out for worker misclassification

In recent years, the Department of Labor (DOL) and IRS have been scrutinizing the use of independent contractors by construction companies. The two agencies are concerned about businesses that misclassify employees as independent contractors — whether intentionally or inadvertently — thereby avoiding overtime, unemployment compensation, benefit and payroll tax obligations.

Worker misclassification can have serious consequences, including liability for back wages, back taxes, unpaid employee benefits, and penalties and interest. In one recent case, the DOL ordered a homebuilder to pay $48,000 in back wages and penalties for misclassifying employees as independent contractors and failing to pay required overtime.

The new overtime rule increases the advantages of using independent contractors, so it's likely that the government will become even more vigilant in the future. That doesn't mean you should avoid using independent contractors but, when you do, be sure you classify them properly.

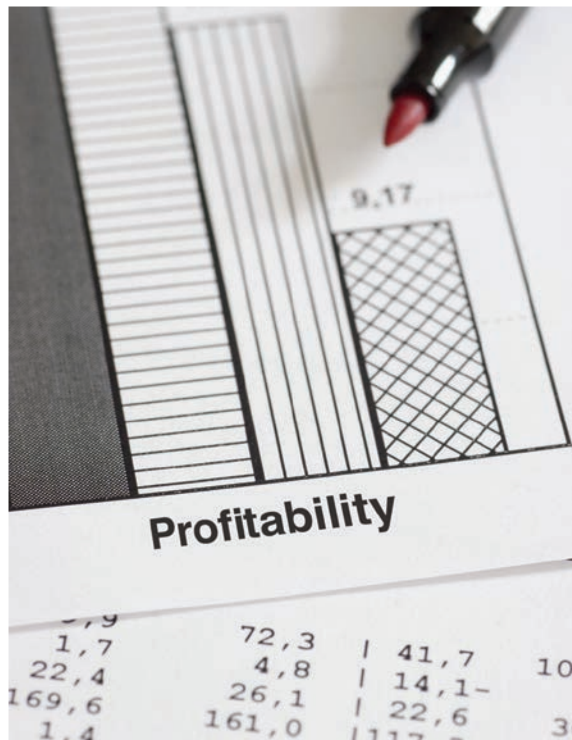
Stopping the scourge of profit fade

Profit fade — a gradual decline in expected gross profits over the course of a project — can be the bane of many contractors' existences. This scourge may not only hurt your financial performance, but also may raise a red flag with sureties and lenders. To avoid profit fade, you'll need to identify its causes, monitor work in progress and act quickly to address any issues you uncover.

Spot the causes

So just what can cause profit fade? Many things, and often a combination of them, including:

- Poor or overly optimistic estimating,
- Inaccurate job costing,
- Unbillable extra work or change orders,
- Unsatisfactory performance by subcontractors or suppliers,



- Lax project management or field supervision,
- Inadequate resources or training, and
- Adverse weather conditions or other unexpected jobsite challenges.

It's normal to experience any one of these over the course of your business. However, if your jobs regularly suffer from profit fade, it's time to take steps to mitigate the problem.

Follow these tips

Here are several tips for preventing profit fade:

Examine your systems and procedures. Evaluate your estimating and job costing systems and procedures to be sure they're accurate and complete. Consider using more conservative assumptions in your estimates. Build in contingent costs to provide a cushion against unanticipated delays and expenses.

Review your past jobs. Analyze past jobs to look for patterns and trends. Is there a correlation between profit fade and certain factors, such as job type, location, contract size or customer? Is profit fade more likely to occur on jobs involving certain estimators, project managers or other personnel? Talk to employees involved with those jobs to identify any factors that caused actual costs to exceed estimated costs. Use this information to improve your estimates and management practices on future jobs.

Scrutinize your contracts. An ambiguous or poorly drafted contract can quickly lead to unanticipated costs — particularly if you and your client have different expectations regarding the work involved. Be sure your contracts clearly define the nature and scope of the work you're expected to perform and provide straightforward change-order procedures to ensure that you're compensated for extra work.

Create budgets. It's impossible to determine whether a job is veering off course unless you've mapped out your route in advance. For each job, develop a thorough, realistic budget tied to the original cost estimate and establish procedures for reporting actual and expected completion costs as the job progresses.

Monitor work in progress. You must monitor a job's progress and investigate discrepancies between budgeted and actual performance. Regular work-in-progress reports can help you track contract prices, amounts billed, costs incurred to date, projected final costs and estimated gross profits. Continually monitoring this information allows you to spot problems early and resolve them before they do irreparable harm.

Avoid surprises

In the construction business, no one likes surprises. You don't want to discover after completing a job that it wasn't nearly as profitable as you'd anticipated. By taking steps to mitigate profit fade, you can avoid such surprises, fix problems before it's too late and ensure that your jobs perform at a high level from beginning to end. ■

Zero net energy building: Hot trend getting hotter

Zero net energy (ZNE) buildings — both residential and commercial — are a sustainable construction approach in which the building has a much smaller energy impact. ZNEs have continued to show significant growth in recent years. In fact, the increase prompted the U.S. Department of Energy (DOE) to release a common definition for ZNEs in 2015.

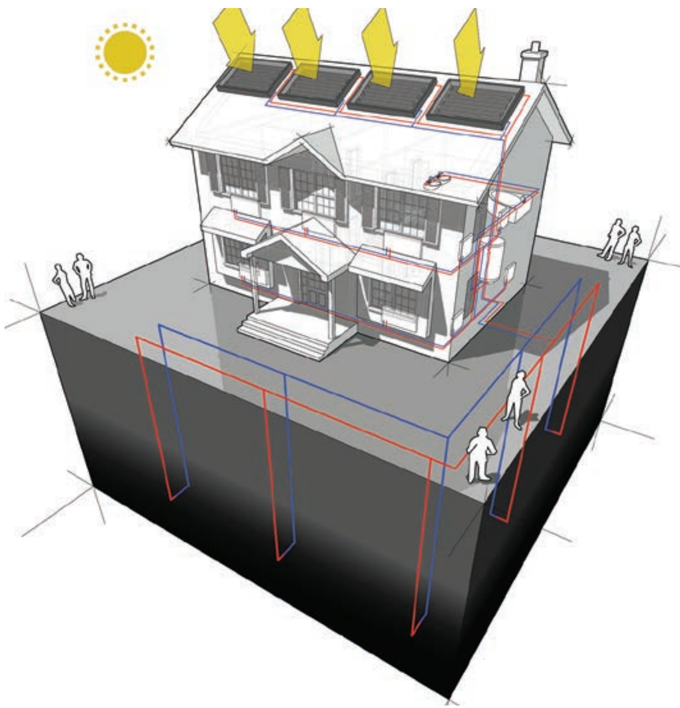
What's ZNE?

The DOE defines a ZNE building as "an energy-efficient building where, on a source energy basis, the actual annual delivered energy is less than or equal to the on-site renewable exported energy." Source energy includes utility-scale gas, coal, nuclear and hydro energy. Onsite renewable energy includes solar power, wind energy, "super" insulation and sub-basements that gather stable underground air temperatures.

According to Navigant Research, California is leading the way: The state's goal is to have 100% of the state's new residential construction be ZNE starting in 2020, with commercial construction following by 2030.

What are the goals?

The DOE has joined the march toward energy reduced construction. It intends to create a technology and knowledge base for cost-effective ZNE commercial buildings by 2025.



The Navigant Research report stated that the ZNE residential homes market is beginning to emerge. To increase the growth of ZNEs, the industry will need to see:

- An increase in stringent building codes,
- Onsite energy generation to help offset growing energy grid loads, and
- New technologies becoming mainstream.

The report expects 27,000 total units by 2025.

What are the benefits?

The New Buildings Institute notes that ZNE buildings are higher performing, and offer "superior comfort and healthier places to work and live." In addition, these buildings' use of passive strategies, such as natural ventilation and daylighting (using natural light to illuminate buildings), makes them more resilient to climate change impacts and less vulnerable to energy price fluctuations.

When construction is complete, ZNE building owners will pay less for energy. This frees up dollars to reinvest in the business. And remember: Public interest and demand for ZNE building is increasing and will continue to grow as more states turn to ZNE building. Owners can leverage increased brand promotion and return on investment by using ZNE technology now.

What are the challenges?

Contractors undertaking a ZNE project may face several challenges. These jobs tend to follow the integrated project delivery (IPD) format. According to the American Institute of Architects, when working on an IPD, you'll work collaboratively to "harness the talents and insights of all participants to optimize project results, increase value to the owner, reduce waste, and maximize efficiency through all phases of design, fabrication, and construction." In other words, this won't be a job where you're given the building plans and left to complete the project without input from others.

In addition, ZNE jobs usually involve building information management (BIM) software systems. BIM enables anytime, anywhere collaboration among everyone from the owner to the subcontractors. So it's perfect for creating and implementing complex ZNE designs. If you've never used a BIM system or have limited experience with it, you'll need to get up to speed quickly.

When it comes to costs, these projects can involve a lot of discussion and even debate. ZNE building systems are still evolving, yet owners don't want to spend big money on assets that will be outdated in 10 or 20 years. Thus, you'll likely be working with materials that are of the highest quality, but are also durable and relatively upgradable.

Why not now?

From all indications, ZNEs are the future of construction. Now's the time to do some research to determine whether this type of construction is right for you and your business. Being involved with ZNE building may help position your construction company as a leader in this form of sustainable building in the years ahead. ■

Boost retirement benefits with a cash balance plan

Construction business owners may not be able to set aside as much as they'd like in tax-advantaged retirement plans. Typically, they're older and more highly compensated than their employees, but restrictions on contributions to 401(k) and profit-sharing plans can hamper retirement-planning efforts. One solution may be a cash balance plan.

Defined benefits with a twist

The two most popular qualified retirement plans — 401(k) and profit-sharing plans — are defined *contribution* plans. These plans specify the amount that goes into an employee's retirement account today, typically a percentage of compensation or a specific dollar amount.

In contrast, a cash balance plan is a defined *benefit* plan, which specifies the amount a participant will receive in retirement. But unlike traditional defined benefit plans, such as pensions, cash balance plans express those benefits in the form of a 401(k)-style account balance, rather than a formula tied to years of service and salary history. The plan allocates annual "pay credits" and "interest credits" to hypothetical employee accounts. This allows participants to earn benefits more uniformly over their careers, and provides a clearer picture of benefits than a traditional pension plan.

Benefits for business owners

A cash balance plan offers significant advantages for business owners — particularly those who are behind on their retirement savings. In 2016, the IRS limits employer contributions and employee deferrals to defined contribution plans to $53,000 ($59,000 for employees age 50 or older). And nondiscrimination rules, which prevent a plan from unfairly favoring highly compensated employees (HCEs), can reduce an owner's contributions even further.

But cash balance plans aren't bound by these limits. Instead, as defined benefit plans, they're subject to a cap on annual benefit payouts in retirement (currently, $210,000), and the nondiscrimination rules require that only *benefits* for HCEs and non-HCEs be comparable. Contributions may be as high as necessary to fund those benefits. Therefore, a company may make sizable contributions on behalf of owner/employees approaching retirement (often as much as three or four times defined contribution limits), and relatively smaller contributions on behalf of younger, lower-paid employees.

Of course, there are potential risks to cash balance plans as well. A notable one for contractors is that, unlike profit-sharing plans, you can't reduce or suspend contributions to these defined benefit plans during difficult years. So, if you do choose to implement one, it will be critical to ensure that your construction company's cash flow will be steady enough to meet its funding obligations.

Be prepared

Although cash balance plans can be more expensive than defined contribution plans, they're a great way to turbocharge your retirement savings. Work with your CPA and retirement advisors to decide for sure whether one might be right for you. ■

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