

Assessing New Jersey's Construction Industry

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THE CONSTRUCTION INDUSTRY ACCOUNTS for approximately 20 percent of New Jersey's total gross product. Unfortunately, growth within the construction industry has been modest—at only about 4 percent this year. This can be attributed to several factors, including the residential housing market decline, new legislation, tighter lending and bonding markets, and the increasing cost of materials.

In this article we will review the events of 2007 that had a significant effect on the construction industry in New Jersey, and discuss what may lie ahead next year based on the current situation.

Rising Costs. The costs of a construction project continued to rise this year. Building materials such as copper, steel, petroleum-based products, and cement increased for the third consecutive year. These commodities are expected to show slight moderation in the coming year. Skilled labor continues to be an issue for contractors. The workforce is getting older and attracting new talent is a critical issue for the industry.

Closer Scrutiny. As a result, surety companies are taking a longer look at a contractor's financial statements to determine whom they will bond. Contractors who have experienced difficulties in a tough business market, or those contractors without a proven track record, are finding bonding to be a difficult proposition. Contractors need to show a strong and complete set of financial statements that provide transparency in reporting the activities of the company. Sureties are inquiring about variable interest entities that exist within the contractor's organization. These variable interest entities are required to be consolidated and disclosed in the contractor's financial statements under FIN 46R. (These variable interest entities frequently occur in a contractor's business through separate entities for building and/or equipment rental entities.)

New Legislation. 2007 brought the construction industry many challenges through increased legislation, forcing contractors to adapt to new restrictions. The NJ State Legislature passed a law effective Jan. 1, 2007 requiring tax withholding for unincorporated contractors. The law essentially requires a contractor to withhold, and remit to the state, 7 percent of the total invoice to an unincorporated contractor. An unincorporated contractor would include sole proprietorships, partnerships, and limited liability companies. The New Jersey Division of Taxation has established Form NJ-550 for the monthly reporting of withholdings. Contractors

may avoid this withholding by obtaining a copy of the subcontractors NJ Business Registration certificate.

The legislature also passed the "Construction Industry Independent Contractor Act," which was signed into law this summer. The law was intended to prevent contractors from misclassifying workers as independent contractors, thus denying the worker social security and other benefits they may be entitled to. The state and federal government were losing out on payroll taxes, and the legislature sought to level the playing field for contractors who were compliant with the law. The law carries substantial fines and bans those who knowingly violate the law from bidding on public work projects.

"Pay-to-Play" laws had a direct effect on many contractors this year. The law was designed to prevent the awarding of contracts from being influenced by excessive political contributions. The New Jersey Election Law Enforcement Commission requires that anyone holding contracts with a state, county, or local authority in excess of \$50,000 file an online disclosure statement. Contributions in excess of \$300 to political campaigns or to PACs or PPCs must be disclosed. The deadline for disclosing contributions made in 2006 was Sept. 30, 2007, but it should be noted that the 2007 filing due date has been moved up to March 2008.

A Look Ahead. Most of the prognosticators seem to think that "more of the same" is on the way for the construction industry in 2008, as well as a few new twists. What this means is that while prices for key raw materials like copper and steel should moderate or come down slightly this year, transportation costs are likely to remain a key cost factor to contend with. Growth is expected to continue in the commercial and educational sectors, but the residential sector will still struggle while the subprime mortgage issue continues to unfold. In addition, contractors will have to give greater consideration to the green construction initiative, as building codes and tax credits for these buildings become more prominent. These issues are no longer a passing fad, and the trend to energy efficiency and environmentally responsible construction is here to stay.

Those contractors who have strong strategic plans and a vision for the future will be better prepared to face the challenges common to this sector, including typical seasonality fluctuations as well as the slowing economy they are dealing with today. ■

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