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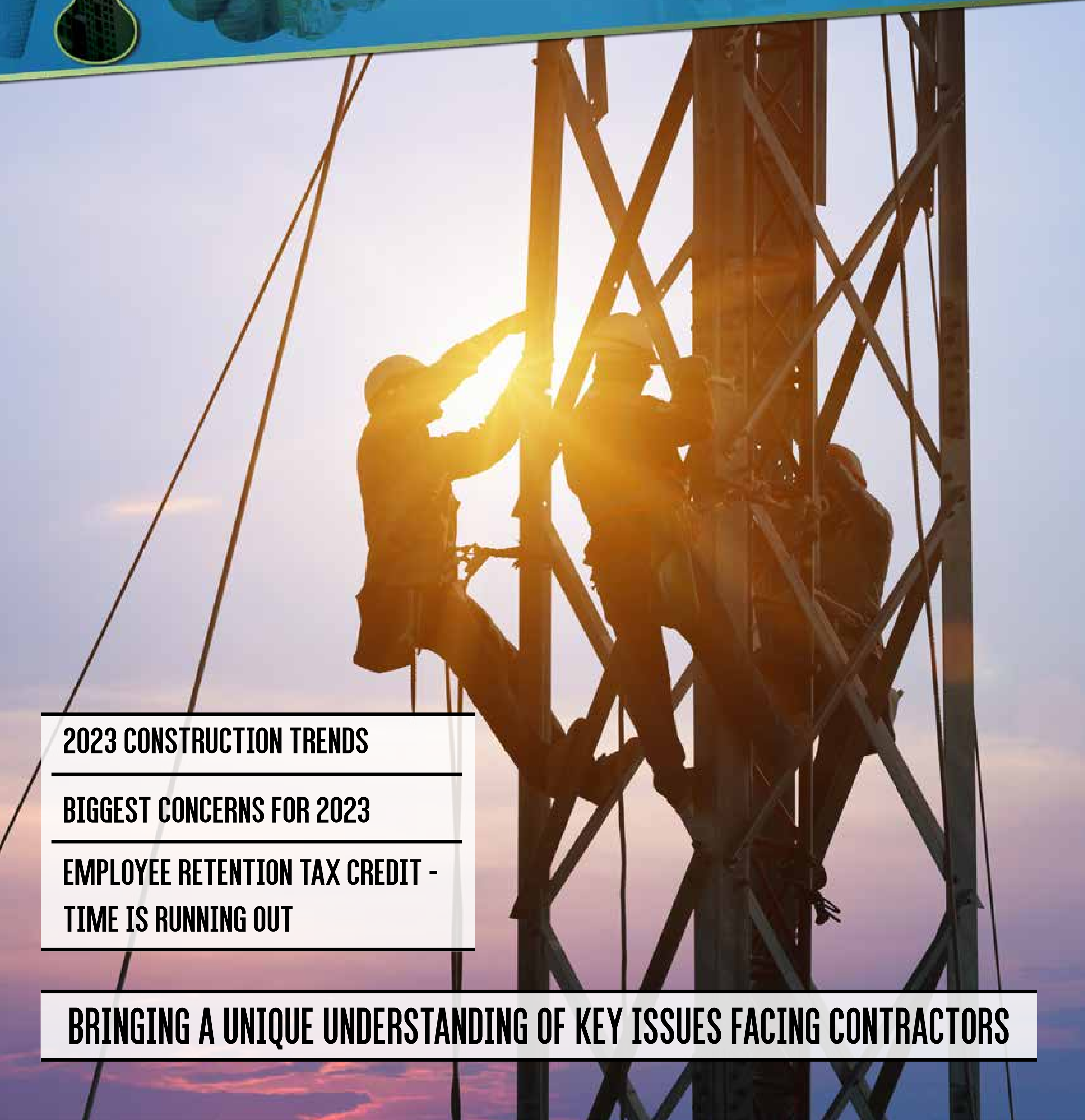

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BRINGING A UNIQUE UNDERSTANDING OF KEY ISSUES FACING CONTRACTORS

FROM THE EDITOR - JOSEPH SCIACCA, CPA

EDITOR

JOSEPH SCIACCA, CPA
CERINI & ASSOCIATES, LLP
PARTNER
(516) 364-7090

CONTRIBUTORS

WRITERS

KIMBERLY MARTINEZ
CERINI & ASSOCIATES, LLP
DIRECTOR

VINCENT IERVASI
CERINI & ASSOCIATES, LLP
STAFF ACCOUNTANT

KEN CERINI, CPA, CFP, FABFA
CERINI & ASSOCIATES, LLP
MANAGING PARTNER

JONATHAN McGRATH
CERINI & ASSOCIATES, LLP
STAFF ACCOUNTANT

ASSOCIATE EDITOR

KIMBERLY ROFFI, CPA
CERINI & ASSOCIATES, LLP
PARTNER

PAGE LAYOUT & DESIGN

KRISTINA (LAINO) TORTORICE
CERINI & ASSOCIATES, LLP
GRAPHIC DESIGNER

Over the years, I have prided myself on providing value added service to my clients. The construction industry has changed so much since I started working with contractors more than 30 years ago, and it seems like things are only gone to change at a faster rate over the next five years.

If you consider where we are and the challenges the industry, and pretty much everyone else, is grappling with – inflation, the economy, interest rates, the Federal Reserve, recession fears, COVID, China, Russia, Ukraine…the list goes on and on. There's so much uncertainty, with construction companies and contractors smack in the middle of some of the turmoil we are seeing. Some of the challenges we are seeing are:

1. LABOR SHORTAGE:

The construction industry (*like many others*) is facing a shortage of skilled labor, which can lead to project delays and increased costs. This is due to a number of factors, including an aging workforce, a lack of interest in construction careers among younger generations, and immigration policies that make it more difficult for foreign workers to enter the country. This shortage of skilled labor can also lead to increased competition for workers, which can drive up wages and make it more difficult for companies to find the workers they need. Companies need to embrace new ways of attracting talent, while retaining the valuable talent that they already have. Embracing technology, employing new recruiting methods, and appealing to very young candidates may yield positive results and help offset the otherwise shrinking employment pool.

2. RISING MATERIAL COSTS:

The cost of materials, such as lumber and steel, has been increasing in recent years, making it more difficult for companies to turn a profit. This has been due to a variety of factors, such as tariffs, natural disasters, and supply chain disruptions. While some relief has been felt lately, companies may have to pass these increased costs on to customers and consumers, which still can make it more difficult to compete with other companies. A close review of expense overhead and materials sourcing could lead to positive results in this area. Running a lean operating is essential in an inflationary marketplace.

3. LACK OF AFFORDABLE HOUSING:

The shortage of affordable housing is a major issue in many regions, and construction companies are struggling to keep up with demand. This can be due to a variety of factors, such as zoning regulations, land costs, and the high costs of construction.

4. ENVIRONMENTAL REGULATIONS:

Construction companies must comply with a variety of environmental regulations, which can be costly and time-consuming, and of course, ever-changing. These regulations can include requirements for energy efficiency, water conservation, and the use of sustainable materials. With changes in administrations and lack of consistency in leadership, it can often feel like hitting a moving target. Understanding the regulations upfront is essential. Invest time, effort, and energy before embarking on major projects to avoid penalties, litigation, and assessments later.

5. SAFETY CONCERNS:

Ensuring the safety of workers on construction sites has always been a major concern for companies, and they must comply with a variety of safety regulations, which, like environmental regulations above, seem to only be getting more complicated and involved. This can include requirements for personal protective equipment, fall protection, and safety training. Companies need to conduct regular safety audits and inspections to ensure that they are complying with safety regulations.

6. ECONOMIC UNCERTAINTY:

The construction industry is closely tied to the overall economy, and economic downturns can lead to decreased demand for new construction. This can lead to a decline in construction activity and a decline in employment in the construction industry. Right now there are differing views on whether inflation is slowing quickly enough, if the economy is destined to enter a recession, and really what comes next. Fear alone can manifest itself as detrimental to consumer and business confidence, which in turn can impact the appetite for construction projects and activity. Companies may have to adjust their business strategies to adapt to changes in the economy. Stay nimble and connected to what's going on in the economy in general.

7. TECHNOLOGY AND INNOVATION:

Companies must adapt to the new ways of working, with the incorporation of new technologies and processes. This can include the use of **Building Information Modeling (BIM)** software, drones for site inspections, 3D printing, and virtual reality for design and planning. Companies that are not able to adapt to these new technologies may find it more difficult to compete with other companies. Embrace these technologies or risk losing business to more aggressive tech-savvy competitors.

8. DELAYS AND DISRUPTIONS DUE TO COVID-19:

The pandemic has caused many delays and disruptions in the construction industry, including supply chain disruptions, worker shortages, and changes to regulations. Companies had to implement new safety procedures and protocols to protect workers and comply with regulations related to the pandemic. While COVID-19 no longer seems to be the sole focus of the world and news cycle, its ill-effects are still being felt today.

Economic uncertainty seems to benefit no one. We're all in this together, facing similar trials and tribulations. At least some of the matters raised above are hopefully transitory, but until these pressures abate, it's important to stay vigilant, flexible, and attentive to what's going on around you.

We are here for you, to help you work through your challenges, to provide insight into the sector, or to be a resource to bounce things off. Please stay connected … we are here to help you, any way we can.

2023 CONSTRUCTION TRENDS

The climate we find ourselves in for 2023 should not be a surprise to anyone, given the year we had in 2022. As much as COVID was the disruptive factor impacting everyone in 2020 and 2021, the significant level of funding pushed out by the federal government kept the economy afloat. Unfortunately, the large influx of cash flow, supply chain shortages, low-interest rates, a tight labor market, and a strong stock market boosted spending and created 40-year highs in inflation rates. Unfortunately, the long-term impact of these conditions was an economic downturn that started in 2022 and will most likely continue to be a factor throughout 2023.

THE ECONOMY:

In January we started to see a loosening of the labor market, however, expect unemployment to stay below 5% until the 2nd or 3rd quarters of the year. Anticipate inflation to start leveling out between 5% and 6% by the second or third quarter of the year and expect the Feds to boost interest rates another ½% to ¾% before the year is out, with no relief until 2024. So, *what does this mean for the construction industry?*

- Expect construction material costs to increase during 2023 by another 6% to 7%, this coming on the heels of double-digit increases during 2022.
- Supply chain shortages have been an issue and will most likely continue to be an issue as we move into 2023 as the cost of production continues to rise, COVID and other disruptions remain prevalent, and the labor market continues to be stretched. This creates project delays, logistical headaches, inconsistent labor needs, and decreased margins.
- During 2022, contractors saw cancellations of contracts due to rising costs. Expect that trend to continue as consumer discretionary resources are shrinking and interest rates are negatively impacting new construction and major improvements. This is also anticipated to drive down home pricing further shrinking margins.
- The tight labor market in the construction industry will continue with 6 times more contractors expecting to be expanding their labor forces than those reducing them. This will drive up the cost of labor and the benefits that will need to be offered to attract and retain staff. On a positive note, according to 2022 data, the percentage of construction industry wage and salary workers belonging to unions dropped to a record low of 11.7% in 2022, a decline from 12.6% in 2021.

GOVERNMENT PROJECTS:

In 2021, the federal government passed the **Infrastructure Investment and Jobs Act (IIJA)** which directed $550 billion toward traditional and next-generation infrastructure projects, representing one of the most significant infrastructure investments in U.S. history. In the first year since its passage in November 2021, the disbursement of federal funds to the various states has been on track, resulting in progress on projects and new contracts for engineering and construction firms. Although IIJA funding is already having an impact, it is expected that the projects announced in 2022 are only a fraction of what is to come. In 2023, expect to see continued rollout of IIJA's funds, combined with other recent legislation. This could bode well for construction companies that have governmental relationships and the capacity to handle these projects.

COMMERCIAL REAL ESTATE:

While we are seeing a softening of the residential real estate industry, certain pockets of the commercial marketplace are still strong, as indicated by the **American Institute of Architects Architectural Billing Index (ABI)**. New project work coming into architectural firms, as well as inquiries for future projects, have been very strong, indicating design revenue at architecture firms will continue to grow. The ABI tends to be a leading indicator for construction projects, which bodes well for the building construction market for 2023.

During the tail end of 2022, there was growth in the retail market, modest gains in the office sector, and signs of recovery in the hotel sector, and the industrial market is expected to have an upturn in 2023. Construction spending in the healthcare sector never declined during the pandemic, and this strength is projected to continue with 5% to 6% gains during 2023. Finally, the education market suffered from remote learning so renovating older buildings and building new facilities was not a budget priority. This sector is projected to gain 5 percent in 2023.

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ENERGY EFFICIENCY AND GREEN BUILDINGS:

By 2025, it is estimated that over 60% of all new buildings will be labeled net-zero-ready (*capable of being built with zero carbon emissions*). This is significant since the U.S. green building market is estimated at over $81 billion, which means an anticipated rise in green building planning and construction over the next few years. The components of a green building are energy efficiency and renewable energy, water efficiency, environmentally preferable building materials and specifications, reductions of waste, toxin reductions, protection of indoor air quality, and smart growth and development. This will require knowledge and understanding of these areas.

Energy efficiency is a large component of green building design. With over 35% of the energy utilized for heating and cooling wasted, practical solutions can help retain energy and ensure efficient building construction and renovations. In addition, recent legislative updates are now offering tax incentives according to the new 179D Commercial Buildings Energy-Efficiency Tax Deduction in 2023 as outlined below.

SUMMARY OF 179D TAX DEDUCTIONS

COMPLIANCE PATH		SAVINGS REQUIREMENT*	TAX DEDUCTION**		
			TAXABLE YEARS BEFORE 2021	TAXABLE YEAR BEGINNING 2021	TAXABLE YEAR BEGINNING 2022
FULLY QUALIFYING PROPERTY		50%	$1.80/ft^2	$1.82/ft^2	$1.88/ft^2
PARTIALLY QUALIFYING PROPERTY	ENVELOPE	10%	$0.60/ft^2	$0.61/ft^2	$0.63/ft^2
	HVAC AND HW	15%			
	LIGHTING	25%			
INTERIM LIGHTING RULE		25%-40% LOWER LIGHTING POWER DENSITY (*50% FOR WAREHOUSES*)	$0.60/ft^2***	$0.61/ft^2***	$0.63/ft^2***

* *Savings refers to the reduction in the energy and power costs of the combined energy for the interior lighting, HVAC, and hot water systems as compared to a reference building that meets the minimum requirements of ASHRAE Standard 90.1-2007 for properties placed in service on or before December 31, 2020. Savings percentages based on IRS Notice 2012-26.*

INCREASED TECHNOLOGY AND AUTOMATION:

The construction industry has a long history of incorporating technology, such as measuring tools and surveying equipment. Digitization will continue its progression within the industry, with even more tasks becoming automated during 2023 as AI and robotics make a greater impact on design, safety, and efficiency.

2022 saw an uptick in the level of automation through digital technologies such as drones, 3D printing, and nanotechnology. These innovations have enormous potential to improve safety, efficiency, communication, and overall productivity across the construction industry. In addition, as **virtual reality (VR)** technology becomes cheaper and more accessible, many builders will likely integrate VR systems into their training programs, design/pitches, and safety testing. This has the potential to reduce labor costs, fewer delays in the timeline, and reduces the amount of rework, overall helping keep costs down and speeding up the construction process.

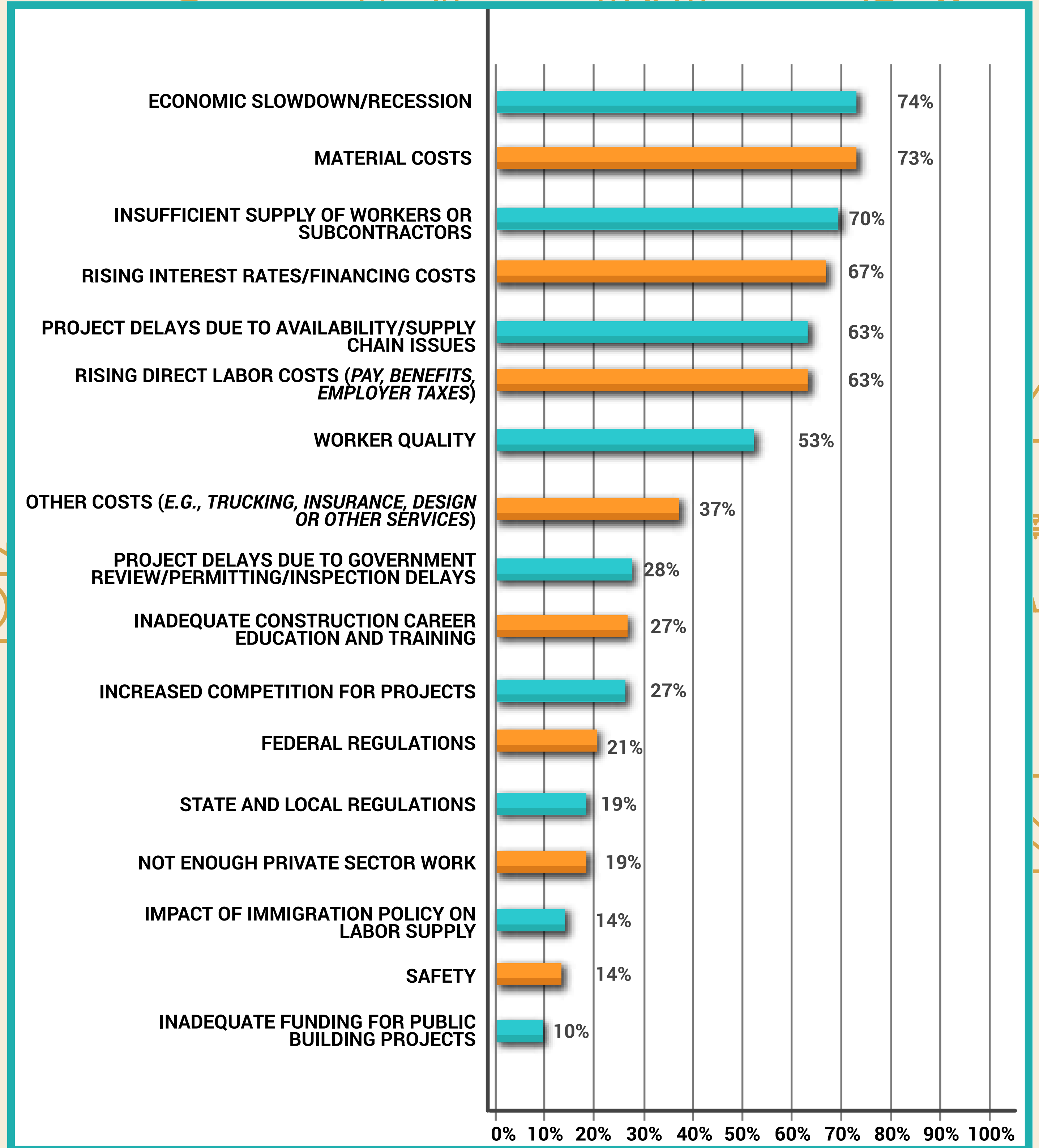
Smart offices and smart homes are becoming an expectation, not a luxury, for businesses and homeowners. This trend will continue to grow in 2023 with increased movement towards integrated systems using Google Home or Amazon Alexa in conjunction with smart appliances and AI. These systems along with the Internet of Things will experience expansive growth … particularly in smart kitchens and bathroom spaces.

2023 will be a year of challenges and opportunities for the construction industry. The economy will cut into margins, the infrastructure bill will continue the flow of large projects, and green energy and technology will reshape the tools and skillsets needed by contractors.

KIMBERLY MARTINEZ & VINCENT IERVASI
DIRECTOR *STAFF ACCOUNTANT*

BIGGEST CONCERNS FOR 2023

ASSOCIATED GENERAL CONTRACTORS OF AMERICA'S 2023 CONSTRUCTION OUTLOOK NATIONAL SURVEY



EMPLOYEE RETENTION TAX CREDIT – TIME IS RUNNING OUT

One of the first relief plans issued by the federal government as part of the CARES Act was the employee retention tax credit or ERTC. Since it was initially released during 2020, there have been many changes to the credit that have made it a bit more accessible for nonprofits and business owners. Even so, we are still receiving questions regarding the credit and who is eligible for it, especially since there has been so much advertising and controversy surrounding it. If you listen to any of the NY based news radio stations, you will hear advertisements for credits of up to $26,000 per employee… *this is the ERTC.*

There were 2 phases of ERTC, the 2020 version and the 2021 version… and they were very different as outlined in the chart below:

	2020	2021
ELIGIBILITY[1]	Less than 100 full time employees (*if you exceed the threshold, you are only eligible for wages or health benefits paid to employees that did not work*)	Same as 2020, except the threshold was increased to 300 employees
DECLINE IN REVENUE THRESHOLD	50% deline in revenue in a calendar quarter compared to the same calendar quarter of 2019 (*excluding other CARES Act funding*), calculated on the same basis as you file your tax return (*cash verse accrual*). The credit stays in effect until the revenue is less than 20% down in a quarter	Same as 2020, except the revenue decline threshold in a quarter is 20%
OTHER ELIGIBILITY[1]	A material decline in operations brought about by a governemnt regulation attributable to the COVID pandemic (*e.g. inability to open*). OSHA regulations that were in effect pre-COVID or curtailment in operations due to an incident of someone getting COVID does not qualify	Same as 2020, except there were a lot less regulations still in effect so it will be more difficult to meet this threshold in 2021
SAFE HARBOR	If you meet the revenue threshold requirement for a quarter, you qualify for the credit in the next quarter	Same as 2020. In addition, if the revenue is down 20% or more in the 4th quarter of 2020, you qualify for the 1st quarter of 2021
AMOUNT OF CREDIT	50% of employee qualified compensation and health benefits up to a maximum of $10,000 of health benefits and salary for the year (*maximum credit is $5,000 for the year*)	70% of employee qualified compensation and health benefits up to a maximum of $10,000 of health benefits and salary for each qualifying quarter (*maximum credit is $7,000 per credit*)
EXPIRATION OF CREDIT	3 years from the date your payroll tax was originally due (*July 31, 2023 for the 2nd quarter of 2020*)	Same as 2020
HOW TO FILE	Form 941X	Form 941X

[1] ***Full-Time employees represent employees that work 30 hours a week or more. If employees work less than 30 hours, they are not included in the count.***

The ERTC is taxable and cannot be claimed for the same wages that you filed for PPP for. This does not mean that if you filed for PPP for a quarter, you can't file for ERTC for the same quarter and same employees, you just can't use the same expenses for both. In addition, if you received any other deficit funding for particular salaries, such as a government grant, you have to make sure you consider this in your application.

Furthermore, there has been a lot of abuse surrounding the ERTC filings, so the IRS will be auditing ERTC filings for appropriateness, so it is important that you maintain strong documentation as to why you qualify, how you calculated qualified compensation, and that you properly considered other funding.

Also keep in mind that, as discussed above, the ERTC, unlike the PPP, is subject to income tax and is taxable in the year the credit is taken for. So if you are a December 31st taxpayer, you will need to file an amended 2020 return for any credits you received in 2020 and an amended 2021 return for any credits received in 2021.

The ERTC regulations are somewhat complex, but we can help you navigate the these credits… but keep in mind that the credits do start to expire by July 31, 2023.

KEN CERINI, CPA, CFP, FABFA & **JONATHAN MCGRATH**
MANAGING PARTNER *STAFF ACCOUNTANT*

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Cerini & Associates, LLP
www.CeriniCPA.com
P: (631) 582-1600 | F: (631) 582-1714 | 3340 Veterans Memorial Hwy., Bohemia, NY 11716