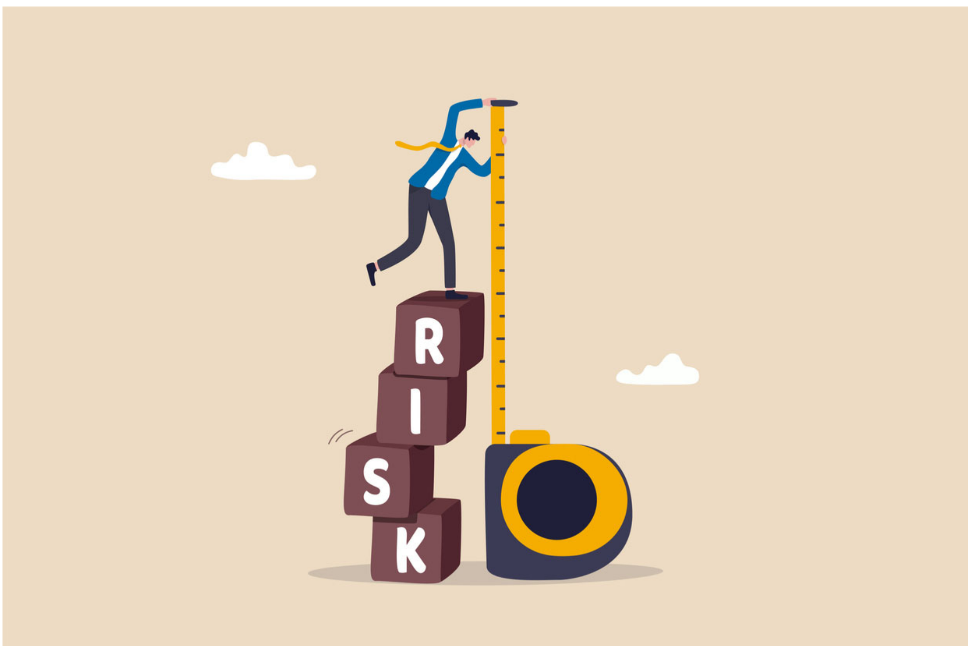
PIPELINE
NATIONAL ASSOCIATION OF SURETY BOND PRODUCERS

Because Construction Isn't Risky Enough: Mitigating Banking Risks

By Carl Oliveri of Grassi



I have always said the construction industry is the most dynamic industry to advise. The executives are entrepreneurial and the technology is cutting edge, not to mention the sector allows us to contribute to a changing metropolitan landscape, leading to long, respected legacies. But with these fulfilling rewards does come an elevated level of risk. The chance for failure is lurking everywhere—within one bad job, mismanagement of cash flow in the CFO's office, and lack of skills on the job site and in the back office.

Credit providers to the construction industry, such as banks and sureties, are constantly evaluating and weighing these risks, as well as their own, when making lending or bonding decisions. This scrutiny of risk is even higher when the credit provider is asked to increase a line of credit or support a bond request out of the contractor's normal scope. The underwriting that goes into these credit decisions is comprehensive and involves analyzing a variety of financial and non-financial data. At times, this process does wear the construction company executive thin, but it is intended to protect interests and mitigate risks for the financial institution.

Considering current events within the banking industry, the tables have turned; and a new risk has emerged for the construction company. Namely, how does the company mitigate the risk of a potential bank failure?

While some could argue exposure to financial loss from the risk of a contractor's bank closing (or being forced to close) is a long shot, it has emerged as a factor that cannot be ignored. In other words, while it is different than the traditional risks associated with insurance or subcontractor default, it is still a risk, nonetheless.

While not an all-inclusive list, the following are some immediate steps construction company leaders can take to address the risk of bank failure and the potential impact on your cash:

1. *Cash Flow Forecasting* – Managing and forecasting cash flow for a construction company is different than other businesses, mainly because the modeling should be done on a project-by-project basis and then rolled up into a global model. This method assists the construction financial manager in identifying when peaks and valleys will occur for investing opportunities and borrowing needs, respectively. Factoring any perceived bank closure risk into this report will position the contractor to take proactive steps before the only step left is to get on the bank run line.
2. *Address the Concentration of Credit Risk* – As cliché as it sounds, "don't keep all of your eggs in one basket." Best practices call for more than one banking relationship, even if it is as simple as having a piece of your liquidity in a money market account. It goes without saying that certain cash balance levels must be maintained at the primary bank to cover payroll, fund taxes, or fulfill other operating obligations. But understanding when excess cash will exist (utilizing cash flow forecasting, as noted above) will give you the opportunity to sweep funds out to a second financial institution and help mitigate the concentration risk. Further, savvy construction companies will make these decisions based on an understanding of the types of accounts their cash is deposited in, how it is being protected and its growth potential, regardless of the bank.
3. *Understanding Your Line of Credit* – A line of credit acts as a safety net for contractors who must front costs on projects in between requisitions, so it is not unusual to see contractors go in and out of their lending facility. This is an essential tool for construction companies, but you must understand the underlying terms and conditions of your line of credit. If bank risk is intensifying, it may not be as simple as transferring funds to another bank. The covenants may call for you to maintain all of the company's cash at the bank or be granted permission to start a relationship with another financial house to keep the line of credit in good standing. You should also be aware of any terms in the agreement that grant the bank the ability to offset any outstanding debt to liquidity, regardless of providing notice of such action. Finally, know what type of line of credit you have. For example, a demand line of credit allows the lender to call the loan due at any time.
4. *Addressing and Planning for the Risk* – At the onset of the COVID-19 pandemic, developing and deploying response plans, for both the office and job site, was a major focus. The industry has watched as these pandemic-centric plans morphed into a "what's next" emergency response plan. Much like having a response plan for a cyberattack, weather event, or whatever else is "next," the construction contractor should develop and deploy a plan to respond to the risk of its bank closing. Yes, in simplest terms, the response is to get the cash out of the bank. But incorporating the three prior steps into one formal companywide document, while engaging in scenario training, will put you one step ahead (and hopefully out) of the bank run line.
5. *Consult with Your Professionals* – The construction industry is unique, and advisors to the industry have unique perspectives and talents to lend to it. Proactive contractors who want to start mitigating this risk should talk to their advisors to hear what their other clients are

doing in terms of developing a response plan and diversifying their cash balances and portfolios. Your professionals may also have insights directly from the bank that could help you make an immediate or longer-term decision.

Knowing which banks are friendly to the construction industry is a great place to start. While the larger banks seem safe to house cash and have a primary banking relationship with, construction does not always fit their risk profile as they may not properly underwrite the industry.

No amount of preparation can make anything in the construction industry risk-free, but taking proactive steps to address marketplace changes and insulating your business from as much risk as possible could mean the difference between profitability or failure.

Carl Oliveri is a Partner and the Construction Practice Leader at Grassi Advisors & Accountants. He specializes in project-centric and companywide financial modeling, operational strategy development, financial statement attest services and income tax method analysis for contractors and subcontractors. Oliveri can be reached at 212.223.5047 or coliveri@grassicpas.com.

7735 Old Georgetown Road, Suite 900, Bethesda, MD 20814   240.200.1270

About NASBP® - Get a Bond - Terms of Use - Join