Five Ways to Price the Job

by Quenda Behler Story

For some jobs, it's difficult or even impossible to come up with an accurate cost estimate. You may not have a complete set of plans, or much of the work may be concealed behind walls that you can't tear into until work actually begins. Whatever the reason, when you don't have a fixed price, you need to write your contract so that you get paid what the job ends up costing. That includes so-called "direct costs" — labor, materials, and subcontracts — plus "indirect" costs — overhead and a profit.

Your contract should describe the pricing formula you will use to calculate the actual price. This description will reduce the number of questions your clients ask when you present the bill. It will also simplify and speed up negotiations if the relationship between you and your clients breaks down and you go to court or arbitration, because you will have already agreed upon the method of calculating what is owed to you. Any pricing language in your contract should also describe how you will calculate the cost of change orders.

Here are five different ways to calculate the price, along with sample language you can use to write your contract.

Time and Materials

In a contract clause where the charges to the customer are based solely on time and materials (with no subcontractors), the problem is what to do with overhead costs and profit. One simple answer is to include overhead and profit in your hourly fee before you quote it. While the hourly figure itself can be very complicated to calculate, it's easy to write the contract language. Write something like this:

> **The customer will pay an hourly fee for all time spent on the job, plus the cost of all materials, and delivery costs.**

You don't have a problem with the cost of change orders when your clients agree to time-and-material billing, but you still need to get authorization in writing to perform any change order work.

Cost Plus a Fixed Fee

In a cost-plus formula, you charge for the actual direct costs of the job — the materials, labor, and subs — then add a predetermined amount of money to cover your overhead and profit. Once you figure out what this amount should be, write the contract like this:

> **The owner will pay the cost of all materials used in construction, plus delivery and handling costs, the wages of all carpenters and other workers for the actual time spent on the job, and the cost of all subcontractors. The owner shall also pay to the contractor for his or her services a fee of $_____, excluding the cost of change orders.**

It's important to exclude change orders from your fixed fee. This will enable you to charge a separate fee for change orders, which is only fair, since changes typically increase the amount of work you will do. Any fixed fee you calculate before the job starts will not take this extra work into account.

Cost Plus a Percentage

Customers like to see a fixed fee because they prefer a contract with dollar amounts in it that don't change. Unfortunately, overhead costs *do* change. For example, you may assign a dollar value to the use of your trucks, but you might use the trucks more than you figured. If you're using a fixed fee to cover overhead, the extra truck usage will reduce the amount of money in the contract that's available for profit.

It's more realistic to calculate overhead and profit as a percentage of the actual direct costs. To create a method for calculating a fee that fluctuates up or down with actual costs, use contract language like this:

> **The owner will pay the cost of all materials used in construction, plus delivery and handling costs, the wages of all carpenters and other workers for the actual time spent on the job, and the cost of all subcontractors. The owner shall also pay to the contractor _____ percent of those amounts for the contractor's overhead costs and profit.**

This language ties the percentage to the direct job costs of materials, labor, and subs. You could tie the percentage to any one or two of those — or to anything else — but remember that a percentage has to be a percentage of *something*.

Cost Plus a Percentage Up To a Guaranteed Maximum Cost

Sometimes you can ease your clients' fears about a cost-plus-percentage method that doesn't define the exact dollars in advance by offering a guarantee that the job will not go over a certain maximum amount. To do that, add the following language to the sample clause for Cost Plus a Percentage:

The contractor guarantees that the total cost of the work including his or her fee shall not exceed the sum of $_____, excluding the cost of change orders.

Cost Plus a Percentage With a Guaranteed Maximum Fee

Your clients may worry about using a contract that contains no exact dollar amounts, but you should be worried that the costs of materials might go sky-high during the job (remember lumber in 1992?). One way to ease everyone's fears is to apply the guaranteed maximum only to overhead and profit:

The owner will pay the cost of all materials used in construction, plus delivery and handling costs, the costs of all subcontractors, and the wages of all carpenters and other workers for the actual time spent on the job. The owner shall also pay to the contractor an overhead and profit fee equal to ____% of the these amounts but no more than $_______, excluding the cost of change orders.

Mix and Match

None of these clauses is written in stone; you can tailor them to your particular needs. You might want, for example, to separate profit from overhead. Or you may want to calculate profit as a percentage of both direct costs and overhead. Whatever you decide, if your contract spells out the way the amount owed you for the work will be calculated, you'll increase your chances of getting paid without a fuss.

Quenda Behler Story *has practiced and taught law for 25 years. She and her husband are partners in a remodeling company in Okemos, Mich.*