Adapting to Market Price Fluctuations

by Dennis Dixon

Nothing is static in the world of construction materials and services. The marketplace is always changing in response to local and global economic conditions, federal and state legislation, even the weather. To stay viable, your construction business must be able to accommodate those changes.

For an example of marketplace conditions that have an impact on our industry, think about oil prices. They don't just affect the prices of oil-based products; the cost of fuel affects the transportation costs of everything, including getting your crew to and from your job sites. And even when fuel prices are stable, contractors often forget that freight charges for heavy items like steel or glulam beams, granite slabs, brick, drywall, and a host of other materials add costs that must be accounted for in the estimate.

Before Work Begins

Here's a short list of things you can do to avoid pricing surprises in the jobs you are currently estimating.

1. Ask your vendors about cost increases. They purchase materials in quantity based on estimated demand, and will usually see price increases coming long before you do. If you are ordering certain materials that might incur a hefty freight charge, consider adding a "freight adjustment percentage" to your contract. It's especially important to keep these kinds of potential upcharges in mind for special-order materials and change orders.

2. Get current pricing for every job. Preparing an estimate for a new project using last month's quote list could eat into your profit. Even a small change is worth noting, because if the price goes up in one cost category, it may also go up in others. A dollar here, a dollar there, and pretty soon you're talking about real money.

3. Plan for contingencies. My cost history for remodeling averages 7% to 12% in expenditures on top of the contract amount. And that's with careful, thorough, anticipatory estimating. I usually recommend to clients that they have a contingency or backup fund, in addition to the amount they've budgeted for the project. If necessary, I can often support this by backing some portion of the work out of the contract and making it optional.

"Not to worry," you may say, "I'm working cost-plus." But you've still given your clients an estimate of what the project will cost, and unless they have literally given you a blank check, cost overruns will come as an unpleasant surprise. If you aren't preparing a line-item budget by cost category, then you're just another "ballpark" estimator. Our clients hire us for our management skills and expertise; ballpark estimators seldom make it to the profit World Series.

After Project Completion

If you finish a job with a significant overrun in one or more cost categories, something was wrong with your job scope or your estimate, or else something is not working properly, like your change-order system. Change orders are particularly troublesome: You're hurt not only by the out-of-pocket loss for unbilled materials and labor, but also by the unpaid cost of any delay in project completion. Because change-order work often extends the completion date, you need to know how much it costs your company to keep a job active. This amount may easily come to \$50 or \$100 per day or more. Adding a week or two to the schedule can quickly erode your profits.

If you find that pricing for certain items is particularly volatile — as has been the case for copper, concrete, and drywall in recent years — consider adding an "escalation clause" to your contract (see "Managing Material Costs With an Escalation Clause," 12/06). This gives you a built-in way to identify (in advance) items that may fluctuate in price, and ensures that if prices do rise, you aren't left holding the bag.

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