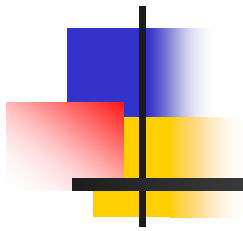




# Pricing For Profit



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*Strategies for  
Small Volume  
And  
Custom Builders*



# Tom Stephani

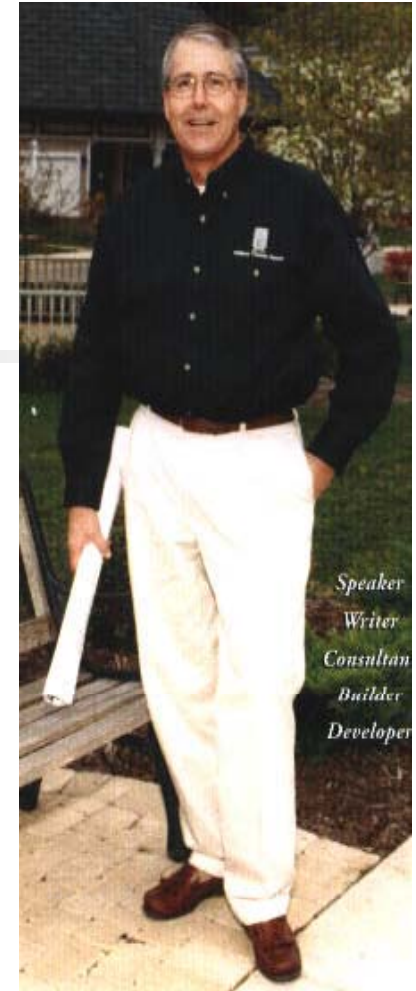
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# Traits of Successful & Profitable Builders

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- **Have a Plan** - Strategic, Business, & Marketing
- **Organized** - Systems oriented (E-Myth)
- **Sell Relationships and Service**
- **Good Financial Management**
- **Use Warranty Work as a Marketing Tool**
- **Delegate** - Surround themselves with strong, talented people



# What is profit?

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Simply stated,  
it is payment for -

- Risks taken
- Capital invested
- Liability exposure

It is your right and responsibility to  
generate a **net** profit for your business.



# Defining “Profit”

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## Income Statement

Sales	\$2,000,000
Sticks / Bricks	<u>1,600,000</u>
<b>Gross Profit</b>	\$ 400,000
Gen. / Admin.	<u>250,000</u>
<b>Net Profit</b>	\$ 150,000

**Mark-up** - 25%

**Margin** - 20%

**Net Profit** – 7.5%



## Define It

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- Mark-Up - Factor applied to costs
- Margin - % of sales price
- Gross Profit - Sales price less job cost
- Net Profit - Gross profit less overhead costs

# Define It

## Markup & Margin, what's the difference?

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- A 15% **mark-up** on a job costing \$200,000 will yield a selling price of \$230,000.
- A 15% **margin** on a job costing \$200,000 will yield a selling price of \$235,294.  
If you build 10 houses per year, the difference between a 15% **Mark-up** and a 15% **Margin** is \$52,940!

# Define It

## What Should SV & Custom Builders Make?

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- Depends on size
- Don't confuse profit with owner's salary & benefits
- Typical Gross Margins for SV & Custom Builders range from 10% - 25%.
- Successful / Profitable builders are usually in the 18% to 25% range.
- Net Profit should be 5% - 10%



# Define It

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## How Do You Price Your Work?

- Detailed Estimating System
- Unit Pricing
- Historical Data
- \$ per Square Foot
- Wing It!
- To the Client's Budget



# Market Based Pricing

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Customer's Perceived Value of Home  
is based on...

- Location
- Size & Features
- Design
- Finishes
- Quality / Reputation



# “What Ever It Takes” Builders

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Buyer's Budget \$350,000.00

Home Cost.... \$ 315,000.00

Balance (margin)\$ 35,000.00 (10%)

A “What Ever It Takes” Builder will design & spec home to fit the owner's requirements and will sacrifice his margin to make the deal work.



# “Bottom Line” Builders

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Buyer’s Budget.....	\$350,000.00	
Subtract Margin.....	\$ 70,000.00	(20%)
Sticks & Bricks.....	\$280,000.00	

A “Bottom Line” Builder will control the design and spec of the home to fit the \$ available without sacrificing his margin.



# Four Steps to Pricing Your Work

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1. Calculate Your Overhead
2. Define Your Sales & Production Capabilities
3. Decide on Your Net Profit Goal
4. Calculate Gross Margin



# Four Steps to Pricing Your Work

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## Step 1

# Calculate Your Overhead



# Components of Overhead

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- Salaries & Burden
- Vehicles & Equipment
- Office Costs
- Insurance Legal & Accounting
- Interest Expense (Operating LOC)



# Components of Overhead

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- Marketing
- Association, Memberships, Publications
- Education
- Travel, Entertainment, Misc.



# Four Steps to Pricing Your Work

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## Step 2

# Define Your Sales & Production Capabilities



# Sales & Production Capabilities

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- Work in the pipeline
- Reputation
- Marketing & Sales Effort
- Historical Volume
- Land Positions, Lot Availability



# Sales & Production Capabilities

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- Market Niche
- Cycle Time
- Economy & Interest Rate Environment



# Four Steps to Pricing Your Work

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## Step 3

**Decide on Your  
Net Profit Goal**



# Net Profit Goal

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- Adjust for owner's compensation
- Industry averages 0% - 20%
- Competition
- Focus on \$ not just %



# Four Steps to Pricing Your Work

---

## Step 4

### Calculate

### Gross Margin Target



# Define It

---

## **Margin is a Function of...**

- Contract Type
- Cost
- Size & Complexity
- Site Conditions
- Location
- Other People Involved
- Hand holding Required



# Zeroing in on the Right Contract For You

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- Who Owns the Lot During Construction?
- Who Provides the Construction Financing?
- Who Guarantees the Price?
- Who Pulls the Permit & Insures the Project?



# Responsibilities - New Home Construction

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- Purchase of Lot
- Construction Loan
- Cost Over-Runs
- Insurance Liability
- Warranty
- Options / Changes
- Design / Errors
- Govt. / Utilities
- Estimate Accuracy
- Clerical Work
- Sub Selection
- Dispute Resolution
- Inspections



## 3 Basic Types of Contracts

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- General
  - Your Lot, Your Loan
- Limited General
  - Their Lot, Their Loan
- Construction Mgmt.
  - Their Lot, Their Loan, They're the GC



# General Contract

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- Pricing Based on Market
- Highest Margins
- Highest Risk
- Most Responsibility



# Limited General Contract

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- Pricing Based on Cost & Market
- Lower Margins
- Lower Risk
- Reduced Responsibility



# Construction Management

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- Pricing Based on Cost / Time
- Lowest Margins
- Lowest Risk
- Least Responsibility



# Components of Construction Costs

<b>High Risk Direct</b>	<b>Low Risk Direct</b>	<b>Job Overhead</b>
Materials	Const. Financing	Supervision
Trades	Plans / Eng.	Liability Ins./ WC
Labor	Bldrs. Risk Ins.	Vehicles
Suppliers	Trash, Utilities, Toilet	Cell Phones
	Commissions	Project Mgmt.
	Permits & Fees	Warranty

What About Land?

# Price / Contract Type / Margin

<u>Home Price</u>	<u>General Contract</u>		<u>Ltd. Gen. Contract</u>		<u>Construction Mgmt</u>	
	%	\$	%	\$	%	\$
<b>200K</b>	<b>18.0%</b>	<b>36.0K</b>	<b>15.0%</b>	<b>30.0K</b>	<b>12.0%</b>	<b>24K</b>
<b>300K</b>	<b>17.5%</b>	<b>52.5K</b>	<b>14.5%</b>	<b>43.5K</b>	<b>11.5%</b>	<b>34.5K</b>
<b>400K</b>	<b>17.0%</b>	<b>68.0K</b>	<b>14.0%</b>	<b>56.0K</b>	<b>11.0%</b>	<b>44.0K</b>
<b>500K</b>	<b>16.5%</b>	<b>82.5K</b>	<b>13.5%</b>	<b>67.5K</b>	<b>10.5%</b>	<b>52.5K</b>
<b>600K</b>	<b>16.0%</b>	<b>96.0K</b>	<b>13.0%</b>	<b>78.0K</b>	<b>10.0%</b>	<b>60.0K</b>
<b>700K</b>	<b>15.5%</b>	<b>108.5K</b>	<b>12.5%</b>	<b>87.5K</b>	<b>9.5%</b>	<b>66.5K</b>
<b>800K</b>	<b>15.0%</b>	<b>120.0K</b>	<b>12.0%</b>	<b>96.0K</b>	<b>9.0%</b>	<b>72.0K</b>

# Construction Management

\$750,000

10% Fee

6% JOH





# Limited General Contract

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\$490,000

14% Margin

6% JOH



# General Contract

\$400,000

18% Margin

6% JOH



# Spec House

\$525,000

w / lot

14% Margin

6% JOH





# Define It

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## **Margin is a Function of...**

- Contract Type
- Cost
- Size & Complexity
- Site Conditions
- Location
- Other People Involved
- Hand holding Required



# Other People Involved

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- Architect
- Interior Designer
- Landscape Architect
- Lighting Designer
- Home Technology Specialist
- Mom, Dad, Friends, “Experts”



# Three ways to increase Profit

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- Increase volume
- Decrease costs
  - Job Cost (Direct & Indirect)
  - Overhead
- Increase margins



# Increase Volume

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## Pro

- Economies of Scale
- Better buying power
- Increased exposure
- More income

## Con

- Management headaches
- Increased Overhead
- Increased exposure & liability.
- Less Control



# Decrease Costs

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## Pro

- Savings flow to bottom line
- Can cut price without compromising margins

## Con

- More effort required on “front end”
- Quality can suffer
- Can “cheapen” the product



# Increase Margins

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## Pro

- Fewer houses / same gross dollars
- Same # of houses / higher gross dollars
- More houses / much higher gross dollars

## Con

- Can price you out of the market
- Harder to sell to clients
- Appraisal problems

# Profitability Chart

# Know Your Numbers!

Homes	1 to 3	4 to 6	7 to 9	10 to 12
Salaries				
Owner	50,000	60,000	70,000	80,000
Super			40,000	50,000
Secretary		12,000	18,000	24,000
Sub Total	50,000	72,000	128,000	154,000
Burden	10,000	14,400	25,600	30,800
Overhead	24,000	36,000	48,000	60,000
G & A	84,000	122,400	201,600	244,800
Commission	2,500	12,500	30,000	41,250
Warranty	2,500	6,250	10,000	13,750
Total CODB	89,000	141,150	241,600	299,800
Effect of Volume and G&A on Net Profit				
Homes	1	4	7	10
Sales	\$ 250,000	\$ 1,000,000	\$ 1,750,000	\$ 2,500,000
10%	(64,000)	(41,150)	(66,600)	(49,800)
12%	(59,000)	(21,150)	(31,600)	200
14%	(54,000)	(1,150)	3,400	50,200
16%	(49,000)	18,850	38,400	100,200
18%	(44,000)	38,850	73,400	150,200
20%	(39,000)	58,850	108,400	200,200
Homes	3	6	9	12
Sales	\$ 750,000	\$ 1,500,000	\$ 2,250,000	\$ 3,000,000
10%	(14,000)	8,850	(16,600)	200
12%	1,000	38,850	28,400	60,200
14%	16,000	68,850	73,400	120,200
16%	31,000	98,850	118,400	180,200
18%	46,000	128,850	163,400	240,200
20%	61,000	158,850	208,400	300,200



# Measure It

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In Order to Effectively Measure Profitability, you must...

- Keep your books in-house
- Have a good “system” for tracking job costs
- Understand basic financial management
- NAHB Chart of Accounts
- Spend the time



# Things That Cause Profits to “Slip”

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- Weak Plans & Specs
- Haphazard Purchasing
- Bad Estimating
- Dragging Schedules
- Poor Change Order System
- Quality Control / Warranty



# Define It

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**When discussing your fees with  
Clients, Realtors, and Lenders...**

**Don't call it,**

**“Profit & Overhead”**

**always call it**

**“Builder's Margin”**



# Summary

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- Profit is not an accident, it is planned
- Customers buy perceived value, not cost
- Margin is not a “One Size Fits All” proposition
- Carefully controlling costs will enhance profitability



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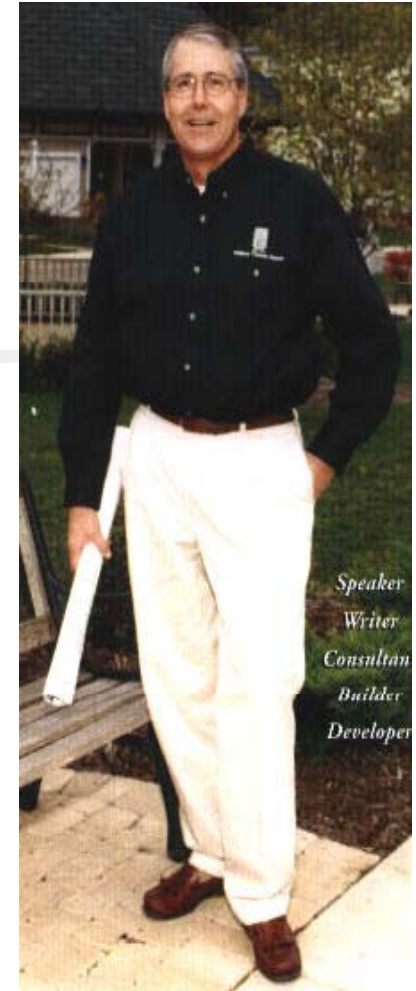
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