

A Change Order Policy That Works

by Paul Eldrenkamp



My change order policy, like many of my construction management systems, evolved over a period of several years. One by one, as I recognized problems with existing procedures, I took steps to improve them. The change order policy I use today ensures that all changes are clearly documented and paid for in advance.

But it wasn't always that way. Before I overhauled my policy, I usually proceeded with change order work based on estimated costs and a verbal agreement. I hardly ever submitted a change order till the end of the job. In fact, I sometimes batched together thousands of dollars worth of accumulated change orders and submitted them along with the request for final payment. Most clients paid, but they weren't happy about it. I never got burned by a client, but I often burned myself. If I'd batched, say, \$10,000 worth of changes at the end of the job, I would realize there was no way I could slap a bill for that much extra money on my client. Instead, I'd cut the charges in half and take a loss because I was embarrassed about the whole thing.

I'm sure every builder has the same kinds of difficulties, which have to do with proper documentation, accurate pricing, adequate contract language, and timely billing.

Proper documentation. The first remedial step I took was to improve documentation of changes. I started using a triplicate form from NEBS (New England Business Service; 800/225-6380) called an Additional Work Authorization. The form looks a lot like an invoice, with room for a brief description of the additional work and for prices. Since the job foreman is in the best position to deal with changes, I made sure my lead carpenters were armed with forms. The forms were usually filled out at the same time the change order work was being done — not perfect, but better than waiting until the end of the job.

Accurate pricing. Once everyone was

in the habit of documenting changes in a timely fashion, I focused on how to price them. Even though the forms had helped me and the lead carpenters to include prices with change orders, the pricing scheme was not profit oriented. It was "good guy" pricing, which amounted to simply passing through the extra work at invoice cost. If a plumber billed \$100 for a faucet, for example, that's how much the client was charged.

Not only did this strategy — or lack of a strategy — fail to cover our general overhead, it cost the company money because change order prices didn't include the expense of estimating the change and preparing the documentation. This approach also did nothing to discourage change orders. Because it cost nothing to explore possible changes, clients requested prices for all kinds of extra work that ultimately was never approved. In some ways it was a misguided effort at service-minded customer relations: I didn't want to be perceived as builder who gouged on price.

Another problem was that sometimes changes had to be made immediately or the job would come to a standstill. This seldom left enough time to prepare a formal change order with accurate prices.

Change Order Pricing Formula

Procedure. Homeowner may be assessed a nonrefundable \$50 processing fee from Byggmeister for every request by Homeowner to determine the feasibility and to provide an estimate of costs of any change in the scope of the construction project. If Byggmeister determines that the change order request requires work to be performed within 24 hours, then Byggmeister will prepare a written change order agreement with a detailed description of the changed or additional work to be performed, the adjusted date of completion, if applicable, and the adjusted payment schedule, if applicable. The costs for the change order agreement to be performed within 24 hours will be assessed by adding the invoice cost of any subcontractors used, plus the invoice cost of any materials used, plus \$35 per hour for work performed by Byggmeister, plus 21% of the preceding total to cover overhead costs.

Figure 1. This contract language establishes a formula for calculating the cost of urgent changes for which there is no time to prepare a complete cost estimate in advance. Other language in the author's contract provides for fully priced change orders when time allows.

Pricing formula. The solution to both problems was to add a clause to our contract that included a formula for calculating and marking up change order costs (see Figure 1). I tried to come up with a formula that was fair, yet generated positive cash flow. The formula charges a flat \$35 per hour for labor, plus invoice cost for subs and materials, then adds 17% gross profit to the total. (You can do this either by multiplying by 1.21 or dividing by .83 — see *Business Forum*, 2/95.)

To make sure we weren't losing on changes, we also made a special effort to include labor in the change wherever it applied. For example, most subcontractor changes require some labor by the GC. It might be only 15 or 20 minutes to prepare an opening for a plumber or electrician, but it should be included in the cost of the change. Additionally, the labor rate in the formula is about 10% higher than our burdened cost for labor. If I underestimate administrative or construction time for a change, this slightly higher rate helps to cover my shortfall.

I also added a \$50 administrative fee to defray the cost of pricing out a potential change order. I consider the fee optional — in fact, I waive it most of the time — but it is designed to discourage the owner from shopping for alternatives. It reminds the owner that there is some cost involved in estimating a change, even if the actual work is never approved for construction.

Custom forms. Having the pricing clause in the contract, however, didn't mean we always followed that policy. Some lead carpenters forgot to use the contract formula; others were not always comfortable with it. Either way, some changes were still being passed through at cost, and there was nothing on the blank NEBS form to indicate otherwise.

To give carpenters a better administrative tool, I created a form in Excel and had it printed in a three-part form (Figure 2). It includes a column for

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Change order authorization form

Project name: PETERS
Change order number # 2

Description of change in work	Job phase	Labor hours	Hourly rate	Labor total	Subcontract costs	Material costs	Profit & overhead	Item total
Re-roof house (see attached specs)	09	2	35	70	3,900	—	833.70	4,803.70
Add Velux VS-106 (see attached sketch)	06	8	35	280	150	291.27	151.47	872.74

Notes:

Paul Eldrenkamp 3/17/95
Contractor signature date

Kim Peters 3/17/95
Owner signature date

Subtotal change orders: **5,676.44**
Administrative fee: ~~50.00~~ *waived*

Total this change order: **5,676.44**
Payment due date: **on signing**

Contract substantial completion date changed to: **5/27/95**

Figure 2. This change order form is an Excel spreadsheet which the author has printed as a three-part form that lead carpenters keep with them on site. It has a column for every element in the contract formula for pricing extra work, and ensures that important elements, such as labor, profit, and overhead are not omitted. The \$50 administration fee, which is usually waived, discourages owners from shopping for prices for change orders that have little chance of being built.

each element of the formula, including labor and gross profit. With the custom form, lead carpenters were able to write changes completely in the field, including takeoff and pricing, providing cost information was available from subs and suppliers. And although I still write some change orders directly in Excel in the office, these change orders are consistent with those written in the field.

In practice, however, lead carpenters often work together with me to prepare the change. It depends on how urgent the extra work is. Because the contract includes a change order pricing formula, we have the option of simply describing the work on the form, then figuring the price according to the formula. This is very useful when a change has to be done quickly. Although I rarely ask an owner to sign a blank change order, I like to have the right to do so.

Collecting up front. The crowning touch of this change order system is that clients pay for changes up front. Instead of waiting for the next scheduled draw

or batching change orders with the final payment, standard practice now is to collect for changes at the next weekly meeting with the owner. My clients have never questioned this policy, partly because I prepare them for it early on when I explain our contract. I also schedule other regular contract payments at the start of a new phase of work instead at the end of a phase. Since clients are already accustomed to paying in advance for other parts of the work, they feel comfortable doing so for changes as well. But if I ever am questioned about asking for change order payments up front, I'll simply explain that I believe payment is due at the time I incur the obligation to do the work.

Besides, it's good to get into a routine of asking a client to pay something at each weekly meeting. If they're suddenly reluctant to pull out the checkbook, it's a red flag that something is wrong. ■

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