

# A COMPARISON OF TIME AND MATERIALS

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# S UNIT COST PRICING MODELS FOR WATER LOSSES



This report compares the two dominant estimating systems in the restoration industry today: unit pricing and time and material pricing. It provides a general overview of each system and their designed use, the pros and cons of each platform, and examines the risks associated with using the various systems. The purpose of this article is to provide the average user with key decision-making information and cautions about applying the estimating models to their business.

*By Kris Rzesnoski, CR, WLS*

There are several unit pricing systems available for use within the North American restoration industry. However, two systems have emerged as leaders, capturing 90 percent of the total market share. One digital system is the dominant player, capturing more than 80 percent market share. Time and materials is one of the oldest systems of costing and charging for restoration work and has many variations, including manual systems and manual digital systems using Excel spreadsheets to fully commercialized digital systems. It is arguably the most used system in the industry.

Both systems have a place in the industry. However, the average contractor may not fully comprehend when to use each system properly or how interchanging the systems can both hurt and help their business. In this article, I will discuss the systems and the challenges involved in using them. For the purposes of this article, I will assume that both systems have a properly completed contract that outlines the pricing agreement and the terms are negotiated before the job commences.

## TIME AND MATERIALS

Time and materials estimating is the method of tracking the labor rates, material rates and applying an additional markup

on trades costs and expenses with pre-negotiated rates. This system of estimating is more appropriately called rate and materials because the rates and cost structures are negotiated before work commences.

Time and materials require the contractor to be very thorough and accurate with their record keeping, notes and accounting for their costs. Having to record and account for every hour worked, every item consumed/used and every receipt for costs can be tedious and burdensome to the contractor who must have specialized resources to effectively deliver on this system.

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To deliver an effective time and materials invoice, the contractor must be transparent and efficient in providing that information to the customer. This allows them to provide a visual representation of the incurred costs in nearly real-time.

Due to the administrative nature of the system and requirement to provide accurate records, the cost of acquiring and preparing information will add cost to the job for the project management, administrative assistants and financial accounting oversight.

This documentation process, when done manually, is administratively cumbersome. In a manual time and materials system, countless hours are spent finding and compiling the documentation from the field and then entering the data to create a record of expense. As technology has evolved, the time and materials system has entered a revolution: a contractor can now eliminate the burdens and the cumbersome processes associated with manual processes.

Technology has evolved further with specialized digital programs that are custom built to deal with the challenges.

Time and materials is a very effective and fair system, for both the client and the contractor, when dealing with unforeseen problems when a job demands additional time and resources. From a perspective of equality, the client pays for the time required to do the job properly, an audit and direct costs that are charged for the job.

Time and materials is a very good system to determine the contractor’s compensation based on their incurred costs to a certain point. Progress payments are typically paid out to the contractor in stages of completion, but there can also be up-front money that is forwarded to the contractor to ensure the job gets started and progresses properly. Additional money may be forwarded based on the

percentage of completion. It is good practice to provide the contractor with 30 percent of the money up-front to ensure that cash flow is available when required. When the job reaches 30 percent of completion, another advance for an additional amount, in this example another 30 percent, will be provided. The work will continue until 60 percent of completion is reached. An additional 30 percent is forwarded to the contractor to finish the job. When the job reaches the 90 percent of completion, the contractor should continue through with the job and allow the 10 percent to be retained to ensure that any deficiencies are dealt with before final payment of the 10 percent is made to the contractor.

The holdback of the 10 percent allows the insured to retain control of the job until completed to ensure that they are satisfied. It allows the contractor to engage in work without the concern about getting too far into a job and running out of money.

There are limits to time and materials, and those weaknesses were exploited by the unit pricing systems in the past and, to a large extent, by today's marketplace.

In the 1980s, 1990s and even today, one of the biggest complaints about using time and materials is the fact that contractors estimate costs lower than their actual invoice. The failure to properly estimate the job leads to a major distrust between the customer and the contractor. The perception is that the contractor lowers the initial estimate budget and then takes advantage of the work needing completion and will increase the time to inflate the budget.

The reality is that there is no good way to estimate the cost of a time and materials job. The basis for the estimate is the project managers' experience in performing that type of work in the past. If they are unfamiliar with the job or the process they are working with, the ability to estimate the job is very difficult. The estimator needs to know the past job cost to predict the future cost and profit margins.

As the degree of difficulty increases, it becomes more difficult for the project manager to manage the job. This difficulty and complexity tend to slow down decisions and the application of resources. This is, in fact, a normal and precautionary process that must be factored into complex jobs. This efficiency reduction is not normally calculated and impacts the projections of cost overruns. Running low or out of consumables, equipment and labor can delay the job and add to the cost that may not be visible at the beginning of the job. The insurance industry is very aware that the longer a job takes to complete, the higher the

chance that inefficiencies will compound and drive the budgets further out of alignment with the initial reserves.

Another factor that is hard to control is that contractors have no incentive to be efficient. The basis for the time and materials system ensures that the contractor gets paid for all the resources they are allocating to the job. The customer has to realize that not all staff will be required every day. However, the ability to complete the job may depend on that staff being compensated to keep them around and paid to use those resources when on the job for other days when work is required. The cost of this process is normally justified to ensure the job is completed as quickly as possible.

Years ago, these costs and delays made room in the marketplace for unit pricing systems to enter the market and gain traction. Currently, delays in collecting and sharing information and the failure to calculate and collaborate these records in an expedited manner are the downfall of the system.

## UNIT PRICING

Unit pricing systems offer a unique value to the industry by allowing the user to identify the specific scope items that need to be completed and associating a price to complete the work. The unit price model addresses some of the main weaknesses of the time and materials model. However, when the user fails to adjust for site conditions, the system fails.

The benefit to the contractor using unit pricing is that a contractor can easily scope out the job and build the detailed itemization for the scope of work. Unit pricing systems do three things for the contractor. First, it allows the contractor to understand the budget and potential cost associated with that job. Second, it eliminates the scope creep that can happen during a job. Finally, it allows all parties to speak to the work completed compared to work in the scope.



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Digital unit pricing systems for estimating and scoping are very effective. The estimator has full control over using the program flexibility and the ability to change efficiency factors, the degree of difficulty of work, working requirements of the customer, and the access or accessibility of the job location. The unit pricing program allows an estimator to start with an average number and increase or decrease their estimate based on actual site conditions.

Unit pricing systems also allows the estimator to create various systems and pricing models of their own to simplify the estimating process. They can easily build their units to account for custom work that they do. Unit pricing systems are a great method of organizing the price list for specific work done by the contractor and allow the development of an individual pricing strategy within the marketplace.

Many challenges with this system are based on the factors in today's insurance/restoration marketplace. The current marketplace is using digital unit pricing tools improperly and without the flexibility to allow for circumstantial changes. The failure to add in new line items, increased demands to limit the use of various line items already in the system, and many arbitrary rules and restrictions have led to adversarial conversations and relationship breakdowns. There is conflict about not following program rules using the unit pricing as a pricing tool. The misuse of the tools is a combination of gaming a system and looking for ways to drive efficiency without the full knowledge and understanding of the impact on the ecosystem.

In the insurance restoration world, only a qualified professional, with knowledge of the restoration processes, should write the scope of work to complete a job. This scope of work must provide the client with a detailed itemization of the scope of work to be completed to prevent

any misunderstandings of what is and isn't going to be completed. The detailed scope allows discussions to happen about what is and is not covered by insurance so that the customer understands their potential risk and cost of the job.

The scope of work should not deviate from the work needed to complete the job properly or be influenced by price (except in exceptional circumstances where all factors have been considered). Price can factor into the equation when multiple solutions result in the same end means. At that point, an economic approach may be a reasonable option if it does not drive delays in getting the job completed. Only the standards of care and professional opinion on restoration process should impact the scope of work. The contractor who is willing to stand behind the price of the work is the only one who can responsibly create a price for the job and provide such a number. The practice of writing a "fair market" number is not appropriate because the writer is not performing the work and does not have any consequences for making a mistake. In many cases, this third party does not know the specific restoration contractors' business, the value of the work to be completed, have the expertise required to complete the work or the liabilities associated with the job. It is not reasonable to put a blanket charge on the work without this knowledge.

Line-item pricing is also marred by some regional challenges and assumptions that are inaccurate and need to be addressed at the time of writing the scope. In some programs, job factors like traffic, drive time and resource acquisition are improperly accounted for. The estimator has to pre-estimate the tasks of the job and the downtime associated with the process. These additional costs must be added in before the job starts to be accounted for properly at the time of invoicing.

## CONCLUSION

It is my opinion that there are only two systems that should apply for invoicing. Time and materials (rate and materials) and bids. The use of digital unit pricing can only act as a tool to help an estimator determine an estimated amount of the loss. After this estimated amount is calculated, the job is charged based on actual consumption of time, materials and equipment or the estimates become a bid value.

This industry does not have the consistency of construction and building sciences that allow for standardized pricing that one line item fits all. Detailed construction work, hoarders, custom homes and commercial structures are just some of the variables that an estimator will run into. One must also factor in the quality of work, the difficulty of access and challenges with the insured. Each factor can

compound and add to the overall cost. This in itself creates various challenges and differences that no unit pricing system will be able to build in without modifications.

The reality is that the systems and customs of the industry are deeply entrenched, and many restorers today forget, or do not possess the knowledge, of the art of pricing their jobs. The culture of the industry has changed. Many restorers are under the false impression that their business can only charge what others tell them is acceptable rates.

A true restoration contractor must know how to estimate the potential severity of the risk, how to keep track and administrate the costs of the job, and how to bid a job based on their costs and charge out needs.

For the restoration industry to go forward, it must go back to the basics. The industry requires digital analytical analysis to build a system of efficiency and profitability in the estimating process. When the insurance industry gets out of the way of the restorer pricing model, the result will be higher efficiency, more transparency and less cycle time at a fair market cost. **RIA**

## RESOURCES

Xactware Solutions (2009) – Xactware Pricing Research Methodology – White Paper – Orem, Utah

Xactware Solutions (2009) – Overhead and Profit – White Paper – Orem, Utah

Restoration Industry Association (2014) – Accounting and Financial Management Guidelines – Canadian Version

Restoration Industry Association (2014) – Accounting and Financial Management Guidelines

ANSI/IICRC S500 – 2015 – Standard and Reference Guide For Professional Water Damage Restoration – Fourth Edition – Las Vegas, Nevada



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