An Inside Look At How Construction Firms Figure Overhead Costs

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In the job costs of every construction project, a portion of the contractor's or construction manager's off-site operational costs are allocated to the jobs they have under construction. These costs are called "overhead costs", and are in addition to fees or gross profit markups included as construction costs to a project. Though some firms may attempt to hide their overhead costs, especially with closed book systems, overhead costs have to be covered by construction firms in one way or another or they will go belly up.

Overhead is defined as "All of the indirect costs which a construction firm has that cannot be directly related to a unit of production and which must be included as a cost to every construction project by some allocation method". Overhead costs for construction firms includes such things as main office rent, utilities, office equipment costs, office supplies, marketing costs, advertising costs, office phones, travel expenses, management and supervisory costs, support staff costs, and so on.

There is one of two ways that construction firms use to allocate these overhead costs to the projects they will be building. There is the Fixed Overhead Percentage Rate method wherein a fixed percentage, such as 16.6% overhead is added to the hard construction costs. There is also the Multiple of the Direct Labor Costs method wherein the hourly dollar wages and benefits of those working on the project times a multiplier is charged as overhead to a project as they are incurred.

Every construction firm has a different overhead rate for its construction projects, be it the fixed overhead percentage rate or the direct labor multiplier method. This is because they all have different main office overhead costs and different Employee wages and benefits packages.

According to industry statistics, the national average of the fixed overhead costs charged to construction projects by construction firms ranges from 13% to over 20%, and the multiplier used for direct labor costs averages 3%. So, how does a construction firm determine what its overhead costs are in order to charge the right amount to any given construction project?

In determining a fixed overhead percentage rate to be charged to a construction project, a firm will add up all of its indirect costs and then will divide this by the amount of construction the firm will put in place for the year. This calculation gives an overhead percentage that is added to the hard costs of on-site construction costs.

For example: If all indirect main office costs were projected to be $3,200,000 for the year and this were divided by what the firm projected would be $20,000,000 worth of construction put in place for the year, this would give an overhead percentage rate of 16%. This would be the percentage amount the construction firm would add to the on-site construction costs as overhead. The more proficient a construction firm is in producing the construction project, the lower the overhead percentage; the less proficient, the higher the overhead percentage will be.

For firms using the multiplier of direct labor costs overhead method, a little different method is used for determining what the multiplier should be. With this method, a firm projects the chargeable hours and base dollar amounts of overhead that will be allocated to the projected amount of construction to be put in place.

For example: If the chargeable base dollar amounts for all projects were projected to be $969,697 for the year and the firm had projected its indirect main office expenses to be $3,200,000 for the year, the $3,200,000 would be divided by the $969,697 to come up with a multiplier of 3.3. This would mean that for every $1.00 of direct labor costs chargeable as overhead to a project, this dollar would be multiplied by 3.3 equaling $3.30 as the actual dollar value of overhead that would be chargeable to a project to cover the construction firm's overhead.

So what method of allocating overhead to a construction project is best for your church? Obviously the lower the fixed overhead percentage rate is for your project, the lower your construction costs will be. The same goes for the multiplier rate. The less the multiplier is the lower your construction costs should be. Just a note of caution for those using the multiplier method…remember the movie "The Firm".

Another note of caution is this. Lower overhead percentage rates or multipliers are not always better nor prudent for your project, just as going to the high end of the spectrum is not always better, nor prudent. A construction firm needs to have adequate personnel available to handle all of its construction projects. A very, very low fixed overhead percentage rate or multiplier may mean the construction firm has cut its staff to the bare bones and may not have sufficient personnel available to handle the construction of your project properly. This may end up costing you more money elsewhere in the project for what money you saved in the line item of overhead costs.