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Pricing Your Service Labor Rate *Simplified!*

Whether your company uses time and material or flat rate pricing, you need to know what your base labor rate must be to recover the costs of running your service department. Many companies are not fully departmentalized in their gross margins, let alone their overhead, which can make it harder to see the true cost of service.

Even without a fully departmentalized profit and loss structure, your service labor rate still needs to be calculated correctly to help ensure the department is covering its costs and producing a profit.

Contractor University provides members with tools to identify the best pricing for your business. Active members can download the Pricing Service Labor Rate Template and Tools (Calculator) in section 5.4 of the Contractor University Best Practices Library for even more help on setting your Service Labor Rate properly.

A Step-By-Step Guide

Understanding and Implementing a Service Labor Rate

Establishing a profitable service labor rate is critical to service department excellence.

Service pricing continues to be one of the most misunderstood and under-managed areas of the HVAC business. Many companies set rates without fully understanding what it costs to deliver profitable service.

The State of HVAC Industry Pricing:

- Most HVAC companies are losing money in service and aren't aware.
- Most HVAC companies are afraid of raising their service rates in fear they may lose customers or think it is not possible to be profitable in service and consider it a loss leader.

Why? The simple reason is most companies do not understand how to charge for what it truly costs to send a qualified, trained service technician to a job, or the true costs of doing business. The cost of 1 hour of wage for a technician, plus the benefit burden, plus overhead is still not an accurate gauge of cost. To properly price, you must look at the entire service operation.

Contractors often allow the market to influence pricing, which is only helpful after they understand their costs. What feels fair or market-allowable can get in the way of profitability.

How Do You Win the Pricing Game?

1. Know your cost of service, as well as other departments.
2. Set your service labor rate properly.
3. Remain vigilant on #1 and #2 because they fluctuate.
4. Understand you probably need to raise your service labor rate.
5. Improve operational efficiencies so you can stop raising rates.
6. Then use the market to position your rates after 1-5 are in control.

Understanding Your Costs

Whatever you charge, you have to understand the fundamentals.

1. **Your Service Efficiency** – Your service efficiency is billed hours divided by paid hours.
   Example: *4 hours billed to customer / 8 hours paid to technician = 50% efficiency*
2. **The Costs of Your Wage for Labor** – 1 hour paid is not the same as what it costs to actually get 1 hour of billable time. For simplicity, assume an example wage of $30 an hour for a technician.
   Please note: *This wage rate is for example purposes only and will vary by location and will change over time due to inflation.*
3. **Effective Wage Rate** - $30.00 x 1.20 (to reflect a 20% labor burden which includes FICA, FUTA, SUTA, and workers' compensation insurance) = $36.00 / .50 or 50% = $72.00 loaded wage rate.
   Since your technician has to work 2 hours to bill 1 hour, your rate needs to accommodate this inefficiency.
4. **KPI's and Industry Ratios for Profit** - The ratio historically for profitable companies is 22%. Meaning $72 needs to be 22% of the rate charged for labor. The service labor rate has to be divided by .22 or 22% to get the divisor figure that will make $72 become 22% of the sale for labor only.

   Example: *$72 / .22 = $327.28/hour as the service labor rate.*
5. **Parts Costs, Taxes, and Markup Factors** - Understanding the true cost of parts is important to creating a total repair cost.
6. **Total Repair** - Bundle up the parts retail price and the labor retail price to get the full repair cost that hopefully covers the costs of the service department.

Labor is the variable that changes. Parts are more predictable. If you mark up a part three times, the part cost gives you what you need to price it properly and protect profit on that part.

Labor does not work the same way. An extra hour or two on a repair can quickly turn a strong labor price into a weak one, and over time, repeated inefficiencies can take a serious toll on margin. That is why efficiency rates should be reviewed at least monthly, and ideally tracked and reviewed weekly.

Parts Markup Example:

Assuming a part cost of $2.90 and a tax rate of 6.75%, the parts markup and calculation of parts retail price would go like this:

Parts Markup Factors	
$0.00 – $4.99	8.00
$5.00 – $9.99	6.00
$10.00 – $49.99	5.00
$50.00 – $99.99	4.00
$100.00 and Over	2.00

1. $2.90 gets marked up times 8 so, $2.90 x 8 = $23.20.
2. The tax of 6.75% is calculated on the part cost of $2.90 and equals $0.20.
3. Add the retail price of $23.20 + the tax of $0.20 to equal parts retail of $23.40

A part that costs $2.90 will be charged at $23.40. The idea here is that small dollars are being generated to cover big overhead costs in the service business. A larger part like a compressor cannot be marked up 8 times, so the amount is bigger but ends up shrinking our gross margin since the markup is smaller (2.00 in above example). The parts markups are set ahead of time and part costs must be kept up to date, while the street labor rate counteracts the lack of billing efficiency.

Establishing a Profitable Retail Service Labor Rate

1. **The easy way to accomplish this is to divide your service direct loaded labor cost by your total *(not just billed)* service labor hours paid. For example, if that average cost comes out to $72 per hour, given a 50% efficiency from the example above, that becomes your starting point.**

   This will account for your inefficiency. By dividing all hours billed off tickets in service by paid hours for those tickets, you are including all operational issues. This can include dispatching errors, travel time, supply house time, training and other non-billable time, so the number will be much higher than your average loaded wage rate.

2. **Take the $72 and divide by the ratio of 22% (the labor standard for service in our industry), equaling $327.28. Let's see what that looks like given a diagnostic fee of $79 billed 500 hours, or half of your 1000 hours billed.**

   Given a $36/hour technician loaded wage rate.
   1,000 hours billed / 2,000 hours paid = 50% efficiency ratio.
   $36 / .50 = $72.00 / .22 = $327.28 per hour service billing rate.

   

   At 50% billable efficiency:
   500 hours x $327.28 = $163,640 in billable revenue.
   500 DX hours x $79 = $39,500 in diagnostic revenue.

   Total of $203,140 in revenues at 50% efficiency.

   Improve to 75% billable efficiency.
   750 hours x $327.28 = $245,460 in billable revenue.
   500 DX hours x $79 = $59,250 in diagnostic revene.

   Total of $304,710 in revenues at 75% efficiency.

3. **Know your parts costs and establish your parts markup tables.**
4. **Know your tax rate – Each state and local municipality is different.**
5. **Make sure your taxes get added to the retail parts costs.**

6. **Know your street labor rate positioning.**

   Are you charging a diagnostic fee to travel to the home and diagnose? This is a common pricing component in a flat rate system.

   Are you going to charge by the ¼ hour, or the ½ hour, the diagnostic and the ½ hour, or are they going to get on flat rate which charges by the task and the amount of labor time it takes for the task?

   There are myriad ways to charge for service, but in the end, it is all about whether you have your base labor rate set correctly to cover your costs, based on efficiency and these factors affect efficiency.

   - Dispatch procedures
   - Truck replenishment
   - Technician competency or new hires
   - Technician billing disciplines
   - Discounts for diagnostics
   - Travel times
   - Supply house visits
   - Pay plans and reward systems
   - Service management tracking or lack of tracking
   - Training and meeting time

7. **Each month, check your average labor cost per hour.**
   Overtime is a labor cost that is reflected by dragging out calls, or worse, loading too many calls on a tech that they just "gas and go" and don't run your service system. A new technician or two can change the way the labor per hour cost is occuring in the company. You don't need to change your rates monthly, but if you hired two new technicians, and another quality technician of yours retired or left, the direct labor cost per hour could have climbed, leaving the company service labor margin in decline at the previous base labor rate.

8. **Track your performance using a service tracking system. What gets measured gets done.**
   Establishing the right service labor rate is critical because it gives your service department the ability to remain profitable, even when efficiency is not perfect. Your labor rate should not be set once and forgotten. It should be reviewed monthly so you can monitor changes in cost, technician efficiency, parts pricing and your average cost per hour. As your team, expenses and operation change, your pricing needs to change with it. Proper pricing protects your margins, keeps your service department financially healthy and helps your company generate the profit it needs to grow.

Try Contractor University Free Today!

Contractor University members receive access to calculators, templates, pricing tools, and worksheets that support the training shared in this labor rate guide. These resources are designed to help you calculate more accurately, understand the financial impact of operational improvements, and build pricing that supports stronger margins and long-term growth.

If you are not yet a member, you can explore the platform with a 10-day free trial and see how the training, courses, coaching, and tools can help strengthen your business.

Start a 10-Day Free Trial

Contractor University Member Resources for Labor Rate Planning

Resource downloads and financial templates are available to full members only.

Pricing Service Labor Rate Calculator

Service Department Street Labor Rate Pricing Video

Contact Us for More Information

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