
My First Spec House: Lessons Learned

Even though we didn't make a bundle, we won some new customers and learned how to better market our next project



I've been building since 1981, mostly custom houses, and always on a cash basis. Last spring, work slowed down for the first time since I've been in business. No one was knocking on the door, and I knew that within a few months I would be out of work.

As it happened, about this time I was looking at building lots with a potential customer. The real estate agent we were working with mentioned that he had recently gotten a loan to build his house. He put *no money down*, yet was loaned 75% of the appraised value of the finished house.

This sounded like a great deal, so I began to investigate getting such a loan and building a spec house. My idea was that if I could manage to build the house with the loaned cash, then sell for the full appraised value, I would be able to pay off the loan and possibly make a profit. I usually mark up my work 25% to 35%, so I was sure the 75% loan would give me the money I needed to at least cover my costs. Even if I didn't make a big profit, this was a better alternative than running out of work and laying off my crew.

Decisions, Decisions

Before I went to the bank, I had to answer some basic questions. I knew why I wanted to build a spec house, but I had to decide who I was building for, and where and what kind of house I would build.

Location, location, location. I started my

research by looking at where I might want to build. I talked to real estate agents and other builders to get an overview of the new house market in my area. I also borrowed a multiple listing directory to see which neighborhoods were hot. In my area there were two neighborhoods where houses were selling well. But that was also where there was the most competition for building lots, and consequently the land developers were not really motivated to give favorable terms. So I looked instead at a third neighborhood where the market was slower. Here, the developers were more willing to discount lot prices, because they were anxious to get some activity in their developments.

I found a developer who was willing to defer 50% of the lot price until the sale of the house. He was especially interested to have finished houses in his development in time for a "Parade of Homes" tour sponsored by the local Home Builder's Association and scheduled for the fall. His development already had three completed houses, another contractor committed to build a spec house, and three or four other lots sold. This seemed like an up-and-coming neighborhood, and considering the favorable terms, I decided to build there and chose a lot.

Price range. Next I had to decide on a price range for the house. This was largely dictated by what had already been built or was currently under construction. The house across the street was selling for \$156,000 and the house being built next door

was priced at \$169,000. It made sense to be in the same price range, so I settled on \$170,000.

I checked the multiple listing directory to find out how many houses had recently sold in the \$170,000 price range, and what their average length of time on the market was. In the immediate area, 17 comparable houses — a significant number — had sold in the past year after being on the market for only three to four months. I later found out that this was not a completely accurate measure, since these houses might have been listed earlier with a different real estate agent. Also, some houses are not put in the multiple listing service. However, at the time, I had reason to believe that I was in a good price range in a fairly good market.

What Kind of House?

This was by far the hardest decision. Having set a price, I began to research the features buyers look for in the \$170,000 range. I looked at home buyer surveys in trade magazines and used a National Association of Home Builders survey, titled "What Home Buyers Want," that identifies trends in the housing market. This is useful information if you're considering speculative building. You can get a seven-page summary of the survey free from NAHB's Economics Department (800/368-5242, Ext. 434). The survey rates features that improve a house's marketability. It looks at all kinds of things — house design and layout, kitchen and bath features, floor coverings, ceiling heights, even where to put the washer and dryer. The survey further categorizes by the buyer's age, income, and occupation, and whether they're shopping for a starter house, a move-up house, or an "empty nest" house.

Considering the prices in the neighborhood where I was building, I ruled out building a starter home. The location seemed good for a family with teenage kids, a move-up buyer with young children, or perhaps a retired couple. I had selected one of the few level lots in the development, which I thought would be appropriate for a backyard where kids could play or a garden spot for retired couples.

I was eager to build a home with unique features, but in the final analysis I wanted to make a profit. I knew that the longer the finished house stayed on the market, the less I would make. So I had to balance the cost of carrying the loan against the cost of amenities that might help the house sell quickly. I was willing to trade off some of the potential profit for a few special details that would show well during the Parade of Homes and possibly generate more business.

Choosing a plan. As a custom builder I enjoy design work. But for a spec house, I decided to use a stock plan. Many companies sell plans designed for different markets (first-time buyers, couples with children moving up, single people, retired couples) and different lot types (sloping, corner, narrow, etc.). These companies make it their business to stay aware of national trends and they design houses with the features that are currently popular. A good plan service will tell you which plans are selling well and will even recommend specific plans for your particular site.

I chose a plan, by Design Basics (11112 John Galt Blvd., Omaha, NE 68137; 800/947-7526), which met all my requirements; it turned out to be the best-selling plan this company offered. It was a two-story, 2,400-square-foot plan that included a great room with 13-foot ceilings and a fireplace, four bedrooms, and a side-entry two-car garage. Among the bedrooms was a first-floor master suite, which would appeal to a couple with teenage children who wanted separate sleeping quarters or to an

by Bill MacCurdy

On the day before the author's spec house went on the market, a painter touches up the finish work.



A crew member dresses up the exterior of the spec house with simple landscaping.

older couple who needed to live on one floor.

The roof line was fairly steep and complicated, which I thought would give the house curb appeal as well as create interest in the upstairs floor plan. (It would also add to the building cost, of course.) I decided to focus attention on the kitchen and baths, since these are rooms that typically make a big impression on prospective buyers. I chose high-end cabinets for the kitchen and a whirlpool for the master bath. The plan included a three-sided fireplace between the great room and kitchen. I decided to trim the mantel with classical details and use slate for the raised hearth, creating a focal point between the two rooms.

I hoped these extras would help generate a sale during the Parade of Homes and thus save the realtor's commission, which might in turn offset the extra cost of the amenities.

Bucking the trend. Even though I knew I was bucking national statistics, there was one feature that I decided not to include: a full basement. According to the NAHB survey, 60% of home buyers nationally want a basement. And of these, almost 60% want a walk-out basement or will spend \$10,000 to \$12,000 to finish the basement.

Because I had a level lot, it would have been difficult to create a walk-out or even to get any daylight into the basement. And I hoped that the ample attic storage space under the steep roof would somewhat compensate for the lack of a basement. So I decided instead to spend the money — around \$10,000 — above ground. About that time I learned that a nearby house built over a crawlspace, and with about the same square footage, had sold for \$177,000 after being on the market for only three weeks. This seemed like a good sign and reinforced my decision.

To the Bank

This being my first spec house, I was fairly concerned that the bank might not lend me the money — especially since times were tight. I formalized the relationship with my real estate agent, agreeing that he could list the house but that if it sold during the Parade of Homes he would receive only a 1% commission instead of the usual 6%. After the Parade of Homes he would make the full commission. Then, rather than shopping around for a lender, I got a name from my real estate agent, hoping the connection might help.

My wife, who does my bookkeeping, and I then prepared a presentation for the bank. We wanted to make a strong first impression and give them the idea that we knew what we were doing, even though we had never done this before. Our presentation included:

- **Credit report.** You can have the bank order this for you if you choose, but we thought it wise to get our credit report ahead of time — both to see what our credit was like, and also to check for mistakes the credit bureau might have made. This gave us a chance to straighten out any errors before we approached the bank.
- **Financial statement.** Any time you are applying for a loan, the bank will want an updated financial statement. We had our accountant draw this up, but you can do it yourself based upon recent tax forms. Try to put your best foot forward here. It's especially helpful if you have some cash assets — we had squirreled away \$10,000, which helped our bottom line.
- **House plans and a detailed estimate.** We tried to be as specific here as possible, to convince the bank the budget was on target for the house we wanted to build.
- **Market report.** We gathered together the results of our market

research and presented it in a report explaining why we thought the features of our house would be attractive to buyers in the area.

We hoped all of this would be very impressive to the bank. One nagging worry was that we might seem over-prepared and thus give the impression that we were unsure. We needn't have worried. When I met with the banker, things went very well, and I was told that we would probably hear within four weeks and close soon after. In three weeks we got the go-ahead and scheduled the closing in time to break ground on July 1.

Closing Moments

I had never personally worked with a lending institution and was fairly unfamiliar with the process. In fact, the only closing I had been to was the one for my own house. So I had a few surprises.

First, after showing up alone, I learned that my wife had to be present to co-sign the note. I was a little disappointed in my real estate agent for not pointing this out to me. So I waited with the developer, my real estate agent, and a lawyer (who was representing the developer) for my wife to arrive. In the meantime, there were piles of papers to sign. They were pushed across the table and quickly explained as if no one was expected to take the time to really read each document.

Despite the real or imagined pressure to sign quickly, I tried to look intelligent and still read each document. It was a good thing I did. One document came across the table that required me to pay 50% of the lot cost (\$13,000) at the time of closing. I looked at this twice, then paused, with the lawyer, the real estate agent, and the developer across the table from me, and asked for an explanation. They said that of course I'd have to come up with the \$13,000 down

payment. I said I didn't think that I could sign this. Wasn't this your understanding? they asked. No, I said, and explained that my understanding was that the bank would pay that amount as part of the total loan. They looked at me incredulously.

Trying not to insult me, the real estate agent then left the closing to speak with the bank's loan officer to clarify. Much to their amazement, the banker confirmed what I had told them. Unfortunately, this meant rewriting all the loan documents, so we rescheduled the closing for four weeks later, which was the end of June. Still, we got through the closing and broke ground on July 7 — one week later than planned.

Tight Schedule/Tight Money

My crew was happy to have the work, and went into overdrive to finish the house in time for the Parade of Homes. The actual construction of the house went smoothly, but the budget was very tight. I kept close track of expenses and managed to pay myself for time I actually spent on site supervising and banging nails. In the end, we were able to complete the house with the money we borrowed, but with little to spare.

We just made the parade. During the first week we still didn't have our carpet in, but we got it in for the second week. There was a competition for the nicest house in each price range, which I entered. The judges came by about 5:30 one afternoon, while the carpet installers were in the middle of their work, so the house probably wasn't presented at its best. Even so, I took second in my category, being only four points behind the winning house, which was totally finished, down to the green sod in the front yard.

Parade of potential customers. What interested me more was the number of people coming through the house and trying to cull out the seri-

ous shoppers. We received overwhelmingly positive comments about the house — the colors we had chosen, the special features, and the overall quality. This became an excellent opportunity to show off the company, and to highlight our craftsmanship. We also encouraged everyone to sign up for door prizes being offered by the HBA, and were able to generate a list of prospective customers. (I later followed up with mailings to try to generate work down the road.)

The Parade Is Over

The house was finished, the Parade of Homes was over. Well over a hundred people came through, but nobody bought the house. There were a few who seemed very interested, so we made some follow-up phone calls, but still no luck. Meanwhile, within a month, the house next door sold for \$172,000, though it was 300 square feet smaller and had only three bedrooms. Other similarly priced houses in our area of the county also sold, but we didn't have any serious prospects.

Hindsight. One question that we heard a lot during the Parade of Homes was why there was no basement. We explained the attic storage and the additional cost involved in building a basement, but came to discover, as statistics show, that people buy houses based on their idea of what constitutes a house. So if you grew up in a house with a basement, then you probably feel that a house must have a basement. Therefore, there were a lot of people that wouldn't even consider a house without a basement.

Plus, I had chosen to build in an area of the county that was nice, but not the most popular. If even a third of all local homebuyers came to our neighborhood, and of those, 60% wanted a basement, then we were limited to a small percentage of potential customers. I began to think that not building a basement was a mistake.

We completed the house in the second week of October. We received an offer in February at \$174,900; at this price we stood to make a nice profit. Unfortunately, the day before closing the buyers withdrew the offer because they were getting divorced. Meanwhile the house had been off the market for 50 days.

It was the middle of August, ten months after we had finished the house, before we got another offer. At this point we settled for less (\$169,000) because we were anxious to get rid of the monthly interest payment. Even so, we managed to make a small profit (see chart, next page). Also, we were able to show the house to prospective customers while it was on the market and generated some business from this. We built two presold houses during those ten months and now have four houses going up. I can't say if all of this is a result of building the spec house, but we've never been busier.

Lessons Learned

The neighborhood where I chose to build has since proved to be very popular, and I'm currently building another spec house there. But I've made some changes in my approach.

Basements in the future. I don't think I'll be building any more spec houses without basements — it unnecessarily limits your market. I'll choose lots where basements are practical and economical.

Also, I'm not fond of basements and that may have influenced my decision. In the future, I won't let personal preferences override national statistics about what people want in a house.

Balancing amenities against profit. I also came to realize that I had probably spent more on special features and finishes than was necessary. Other similarly-priced houses in the neighborhood with less expensive cabinets and no whirlpool bath sold more quickly than mine. Other

Spec House Costs

Construction Costs*	- \$142,801
Interest on Loan/	- 11,449
Misc. Costs	
Sale Price	+ 169,000
Realtor's Commission	- 8,450
Profit	+ \$6,300

*Includes lot, contractor's salary, and operating expenses

builders installed 20-ounce carpet; I went with 30-ounce. Clearly, these items didn't help my house sell any quicker, so I was basically just giving these upgrades away.

In retrospect, it's probably impossible to say why the house did or did not sell. Spec building is always something of a gamble. But the more research and analysis that you do, and the more you pay attention to trends and what has and has not worked for other builders, the more you can minimize the risk.

Co-investors. I've also taken on co-investors. Since there's a limit to how much the bank will lend me at one time, I've found partners — people from other professions — who are willing to take on some of the risk and help carry the loan in order to reap some of the profits.

Having been a custom home builder before, I am enjoying having the freedom to make the choices and decisions that go into a project — it also considerably speeds up the process. Spec houses are now making up about half my business volume. For now I'd like to maintain that ratio. In the future, if custom jobs slow down, I hope building on spec will provide the work I need to get through tough times. ■

Bill MacCurdy is the owner of Sun Construction, in Fairview, N.C.