

Strictly Business

Building on Spec

by Bill MacCurdy

I built my first spec house more than a decade ago. Although I'd been building houses for 10 years before that, when I discovered that banks would give contractors construction loans at 70% to 80% of the appraisal value of a finished house, it was great news to me. By rough calculation, if my desired profit was 20%, the construction cost could be covered by the bank loan. However, one thing was immediately apparent: I wouldn't be paying myself until the house sold. (Of course, if I worked on the house, I'd pay myself an hourly wage.) To build on spec, you have to have some savings or other work to pay the household bills. You can't take the first loan installment and buy new tools or take the family on vacation.

Getting Funded

To build a spec house, you have to be able to obtain the financing. Sources of financing include family, friends, and financial institutions. But you have to make a convincing case that you know what you're doing and are a good risk. If you've never built a house before, you'll have trouble convincing your lender to finance your education. Get your building education beforehand, while you're working and being paid. For my first spec loan, I went to the bank with 10 years' experience, about \$10,000 in my checking account, a good house plan, a detailed estimate, and a marketing plan. Thus armed, I got my financing.

Know Your Numbers

It may seem obvious, but I'll state it anyway: Knowing how much the house is going to cost is of paramount importance. If you're off by a few thousand dollars, it won't kill you, but be off by \$10,000 to \$15,000

and you may wind up working for \$5 or less per hour.

Realistic bids. Get bids from subcontractors for every phase of construction, but beware of taking low bids; it can be costly. Signing a \$3,000 electrical contract for a \$6,000 job with some smooth-talking greenhorn electrician is not a good move. More than likely, he'll quit halfway, when he realizes he's about to lose money. You'll have given him the first installment, the job will be

behind schedule, and you'll have to find somebody willing to take over the job, guarantee his predecessor's work, and end up paying what the job should have cost in the first place. If you think the law is on your side, and that lawsuits are a good remedy for this kind of problem, you should be a lawyer, not a builder. It's best to do your homework and avoid unrealistically low bids with inexperienced subcontractors.

Unit price bids can also be budget



Whether it's an upscale second home (top) or a simple starter home (above), match the spec house to the neighborhood you're building in.

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busters. A masonry bid that reads, “\$500 per thousand, plus \$2 per cut, \$1.50 per rowlock, and steps, columns, and arches at \$60 per hour,” should raise an alarm. Nail down the specs for the work and get a firm, reasonable price. Guessing at numbers, saying things like, “\$10,000 should take care of that,” will always sound foolish in retrospect. There’s no substitute for having good numbers from personal experience with your own crews, and good bids from reliable subcontractors.

Job Costing

A good budget means little if you find out that you’ve omitted a cost, like backfill or interest on the loan, or if you throw in extras along the way (a Jacuzzi or hidden ironing board), or make lots of upgrades (architectural shingles instead of three-tabs, or wood floors instead of carpeting). Part of staying on track and keeping good job costs includes not getting carried away. If you’re a custom builder who always works for clients or architects, suddenly doing a job where you make all the decisions and all the product selections can get the best of you.

Establish good numbers and stick to them. Keep consistent records of your invoices, bills, and labor costs in progress, and compare them to your budget to stay on target, or to find out if you need to make an adjustment. You’re building a spec house, so stay with your game plan. Build the Taj Mahal for the maharajas when you’re paid to do it.

The Product

You can finance your house and build it on budget, but if nobody else wants it, I hope you can afford it, because you’ll be moving into it. A little investigation into the housing needs in your market should tell you what to build. Be careful: If starter homes are your specialty, don’t jump



A straightforward plan with simple design elements is typically the safest bet in a spec house.

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into a half-million-dollar house for your first speculative venture (see *My First Spec House: Lessons Learned*, 4/93). If you're building a house to sell, you need a market for your product. What's the average income for a family in your locale? What kind of mortgage can they afford? How many \$600,000 houses sold in your area last year? How many \$200,000 houses? Do you live in a popular retirement area? Are second homes a hot commodity? It's a matter of numbers — you need a lot of people interested in your product.

Target price. Check the real estate section of your local newspaper to preview other new homes on the market and compare the asking price to the square footage. Attend open house events and take note of the home's amenities to learn what's being offered for the money. Real estate agents can be great sources of information. They know what price range homes are selling in, in what part of town, and what amenities buyers want.

Land-to-building cost ratio. Different districts, and different regions of the country, have a bearing on the ratio of land-to-building costs. In my area, the last time I checked, the ratio is about 1:5. Do a little research on the homes in the neighborhood where you're thinking of building to determine an average local ratio.

Location

Real estate brokers say that the three most important factors in selling a house are location, location, and location. There may be a great deal on a piece of property four miles north of town, but if eight out of ten people moving to your area want to live south of town because of the convenience and great school district, that's where I'd look for land. On occasion, I've built in new subdivisions outside the fastest-selling neighborhoods, but only because

they offered values, conveniences, and amenities not found elsewhere, like scenic views, price breaks on lots, and good neighborhood schools.

An Eye for Design

It almost goes without saying that you need a good design and an attractive exterior that works on your lot. A house plan with a rear daylight basement just doesn't work on a lot that slopes to the street. Poor details, like a bedroom that's accessible only through another bedroom (yes, I've seen this), or vinyl siding in a neighborhood of brick houses, are both bad design and bad judgment. Know the difference, or find somebody who does. It's not hard to find out what works, and imitating other, successful builders is not a crime.


If you don't have an eye for design, don't design your own spec houses. Hire someone to design the kitchen or to pick out the plumbing or light fixtures if you're not good at that sort of thing.

Marketing

You can have the best location, and a great house at a great price, but if nobody knows about it, it'll be hard to sell. Plan to spend some money advertising your property — it should be part of your budget. I don't work with a specific formula or percentage of total cost for marketing, but, as an example, for a recent spec house that sold for \$190,000, I budgeted \$1,500 for marketing.

Seriously consider working with a real estate agent. Some builders find it hard to pay a 5% to 6% real estate commission out of their projected 15% to 20% profit. But real estate agents have the connections, the network, and the sometimes considerable time needed to flush out customers for your house. Consider their fee a marketing expense. It's a good idea to consider a real estate commission as part of your total selling price. For

example, if your spec house is going to be priced at \$190,000, your costs, including a real estate commission, and your desired profit should total \$190,000.

Of course, if you sell your house without an agent, you can pay yourself this fee. You may want to keep this option open, even if you're working with an agent, but it'll have to be spelled out in your listing contract. I'd rather pay an agent instead of sitting on an unsold house and paying interest on the loan. 

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