



[BIG IDEAS 2010]

How homes are built is changing. Are you?

by Kim Jackson

There's no such thing as business as usual these days. What was the norm in the home building industry a few years ago doesn't even exist now. Tough times means tossing what doesn't work, fine tuning what does and embracing new ways of doing business. Oh yeah, the industry WILL return. And when it does, it'll be very different from the home building landscape of the past: leaner, smarter and technologically savvy. What follows are strategies smart builders are using to transform their businesses now, while maintaining — even boosting — their bottom lines. »

OUTSOURCING IS THE NEW “BUSINESS AS USUAL” Builders gain profitability and added protection

It's the way business has been done in Hollywood for decades. Japan's philosophy of doing it transformed the auto industry 20 years ago. And while smart builders have been outsourcing most of the trades on their homes for years, profitable builders have discovered that when a few more key functions are outsourced, they save big money on overhead. That tactic puts them in the black on each project.

The top five expenses a builder has are staff, salaries, insurance, purchasing and marketing. When a builder uses third-party warranty and purchasing services, four of those biggest expenses are trimmed: staff, salaries, insurance and purchasing.

HOME WARRANTY SAVES MONEY AND TIME, WHILE PROTECTING AGAINST LIABILITY

For years, many Colorado builders have taken advantage of outsourcing their one-year home warranties. Third-party warranty companies give them a full in-house warranty department, without the overhead of one.

Bill Armstrong is president and owner of ProHome Colorado in Evergreen and Grand Junction. For 26 years, ProHome has taken the reins from builders as they've introduced thousands of buyers to their homes — and maintenance items — during the preclosing walk throughs. ProHome also handles the 30-day and 11-month walk throughs at owners' requests. Because they're no longer having to do it themselves, builders are saving an average of 30 to 60 percent of the home warranty cost.

More than the hard dollar savings is the liability protection builders gain by outsourcing their warranties. ProHome documents every interaction with the home owner, from the first telephone call to final resolution. Armstrong explained that if a builder is sued four or five years down the road, “that third-party documentation in court can be more valuable than a builder's in-house documentation. Our documentation is very concise and organized and I've been an expert witness in a couple of cases for our builders. In fact, I just got a call from an insurance company on a claim and because of our documentation, the insurance company is going to pay the \$16,000 claim they tried to hang on our builder — who built one unit. That's pretty huge.”

As the third-party warranty provider, Armstrong said that he can do and say things on the preclosing walk through a builder simply can't. “We can remove some of that buyer's remorse and help the home owners feel great about the builder and house they've selected to buy.” What's more, as the go-between, home owners more readily accept ProHome's decision on an item than they would when directly talking with the builder. “They often say, ‘Well, I thought I'd try,’” Armstrong said.

He observed that the model consumers are used to when buying a big-ticket item will be more readily adopted

by builders as they transform and streamline their businesses. “Consumers are used to dealing with third parties, until they buy a home,” Armstrong said. “It's such a simple concept. A third-party home warranty puts one more familiar thing in place for consumers. Some builders get it. If a builder can move overhead and not affect his profit center by outsourcing, his quality control and profitability goes up.”

TEN-YEAR STRUCTURAL WARRANTY OFFERS ANOTHER LAYER OF PROTECTION

While a one-year workmanship warranty is a big help to builders from the outset, it's important to have a plan in place if there are any structural concerns. Add to that the low level of confidence consumers have about whether a builder will be in business ten years from now to perform on the warranty, if needed, and it can be a tough sell to move new homes.

Because the builder has traditionally been the only one home buyers can go to if there's a structural problem, many times, the issue ends up in court. Plaintiffs' attorneys can bog down builders with paper work, then point out other problems, making a mountain out of a mole hill. As the mole hill grows, so does the cost to defend themselves.

That alone could be the best reason why some builders have outsourced their ten-year structural warranties. StrucSure Home Warranty offers builders protection on any infraction of the load-bearing portions of the home. Stephanie Beninati, vice president of the Rocky Mountain Region, explained that after receiving a call from a home owner, StrucSure sends a structural engineer out to review the situation. If it's found there is a problem, the company solicits bids, selects a vendor and cuts a check for the problem. “When a builder doesn't have a third-party structural warranty and says there isn't a problem,” she said, “attorneys usually become involved. And the cost of defending yourself now is ridiculous.”

For every \$1,000 in the sale of a house, StrucSure's policy averages \$4; for example, a \$100,000 home structural warranty is \$400. Beninati has found that when builders do include a structural home warranty with the sale of the house — and StrucSure has trained builders' sales people to market it — that warranty and extra layer of protection gives the builder a sales edge, rather than a defensive one.

And because each home is inspected and deemed excellent before becoming covered, the warranty helps smooth and speed the FHA and VA approval process. “All a builder has to do is put our ten-year warranty on their home. We're getting homes closed, and closed fast,” Beninati said.

With a couple hundred projects on the books, Structure's structural warranty program reflects that builders are increasingly streamlining their businesses and aligning themselves with companies that can help protect them, while offering a value-added warranty to their home buyers. "People are going to start doing business differently," Beninati said. "Warranty is another tool that builders can use to make buyers feel more comfortable with them."

PURCHASING DROPS OVERHEAD COSTS, BOOSTS PROFITABILITY

Managing the purchasing function is a big overhead expense for any builder: Getting and comparing bids from trades, selecting one from each category to do the job, matching purchase orders to invoices, issuing partial payments, then ensuring the work is done as expected and on time. Because of the time it takes to manage, purchasing can add up to big bucks for a builder.

Armed with a background in purchasing and a degree in computer information systems, Mark Henderson launched Builder Purchasing Services last March to manage a builder's purchasing administration.

BPS reviews a builder's scope of work, drawings and specifications, so when they go out to bid the project to subcontractors, builders can make exact comparisons with their trades and suppliers. After ensuring the builder's documentation is correct, BPS loads all the information into a database, including cost codes, and launches a bid portal for the builder.

When the project is ready for bid, suppliers review the drawings (eliminating mass-produced drawings), and fill out a bid form on line. Each supplier's bid includes the backup used to submit the bid, so complete information is always available to the builder. Once suppliers' bids are submitted, BPS puts together a comparison report, with the lowest bidder highlighted in yellow for each category. The builder then negotiates and selects his suppliers.

"To cut back and survive," Henderson observed, "a lot of builders have let their purchasing people go. They realize it's a greater value to them to outsource it; we lower their internal overhead because they no longer need administrative people." He estimates that BPS' builder clients have saved 50 to 65 percent on their purchasing administration overhead.

As each trade completes its portion of the project, invoices are automatically generated and paid. Each purchase order directly correlates to a specific activity and matches the budget. Partial payments are eliminated, which frees up time and reduces paper work. "It's how we track job cost," said Mike McMahon, vice president. BPS sends a builder a report every two weeks that shows what's remaining on the job. He added, "We have the capability to actually release checks to the builder for his distribution."

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There's more. Because so many builders rely on equity partners today, and lenders count on builders to stay within budget, McMahon said, "knowing where they are every step of the way is huge. By outsourcing, their costs are fixed; we eliminate variables along those lines. They know going into each unit what it's going to cost."

Looking ahead, McMahon noted that he's been talking with several people, where with just two or three people, they're starting a building company. "They're going to outsource everything," he noted, "because they know they will get the best they can get and they don't want the overhead. This is the time to reinvent yourself as a builder. Outsourcing everything but what you do best is a way to alleviate the total management of in-house staff. You can use them only when you need them."

SALES AND MARKETING RESCUES PROJECTS ON THE BRINK AND GIVES ROI TO INVESTORS

As the landscape continues to change, some projects are abandoned midstream, due to investor nervousness, buyers' inability to get funding or any number of reasons. Metropolitan Residential Advisors was formed to address that very situation and its objective is to maximize return to any investor in a project.

With more than 20 years at Village Homes — her role when she left was president and chief operating officer — Cheryl Schuette is now operating principal for the firm she launched last April. Schuette partnered with Peter Kudla, owner of Metropolitan Homes, to leverage his platform of development, finance, accounting, purchasing, sales and marketing services.

This unique platform lets the firm leverage nearly all the services a developer, investor, land holder or bank might need, including construction services, purchasing, marketing and sales. "A lot of property is changing hands mid stream," she said. "We can come in with a fresh perspective and consult with a group of investors, then price, position and handle the marketing and sales for their property."

MRA has been working with a group of investors who own a high-rise project in downtown Denver. Before working on the project, Schuette said, "They had 109 homes in inventory. When they finished delivering the building late October 2008 through last February, they lost quite a bit of their backlog because their buyers couldn't finance. We helped them to price and position for the market, brought in an on-site sales staff and helped open a new sales center and models to demonstrate the right price point products." The result? Sales have tripled each month.



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