

***Building Your  
Own Home***  
FOR  
**DUMMIES®**

**by Kevin Daum, Janice Brewster,  
and Peter Economy**



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Wiley Publishing, Inc.



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## **Building Your Own Home For Dummies®**

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# *Dedication*

This book is dedicated to all those information hungry consumers pursuing the American dream of home ownership.

# *Authors' Acknowledgments*

Just like a custom home project, it took many people to make this book happen. We consulted experts in every area to make sure we included current, accurate information.

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# Introduction

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**A**s you read this book, you most likely have the seed of a dream taking root in your mind. Your current home isn't all it could be. You've been daydreaming about a different place — one with more land, one by the water, or one with a gourmet kitchen. You've trolled the open houses in your area, but none of the homes really light your fire or seem to fit your lifestyle or your family. You want something that feels more like you.

The only way to get a perfect house “fit” is to design it specifically for you. No matter if your new home is a month away from completion or ten years down the road, you need this book.

In our work, we've seen plenty of people like you tackle the process of building a custom home. For some, the process is challenging, but enjoyable. For others, a custom home project becomes a nightmare that leaves them short on cash and long on anxiety. We understand the process and what it takes to move through it with as little stress as possible. In the pages that follow, we provide you with the very best advice our many years of experience have to offer.

No matter if your dream consists of a simple \$150,000 house in the Midwest or a multi-million-dollar mansion in California, *Building Your Own Home For Dummies* is for you. This book can help you turn your dream of a custom home into reality without losing your shirt or your sanity. With this book and with some hard work and perseverance on your part, your dream of building, owning, and living in your very own custom home can become a reality.

## *About This Book*

Thousands of parts and hundreds of tasks go into a custom home project. This book doesn't tell you how to install a toilet or hang a door (other *For Dummies* books cover those topics in detail), but it does tell you everything you need to know about creating a custom home from scratch. Where do you start? Who is responsible for what? How much will it all cost? These questions — and hundreds more — are what this book answers — and all in an easy-to-use reference that you can take with you anywhere.

We divide each chapter into sections, and each section contains information about some part of understanding the process of building a custom home, such as

- ✓ A comprehensive approach to financing your home project, before, during, and after construction
- ✓ The types of custom homes that are available — from log to timber frame to stick-built to modular
- ✓ A view from the loan officer’s side of the desk
- ✓ A complete look at the inspection process during construction and what the inspector(s) will be looking for
- ✓ Thorough and helpful tidbits on how to successfully build your home and still have money left over

The great thing about this book is that *you* decide where to start and what to read. It’s a reference you can jump into and out of at will. Just head to the table of contents or the index to find the information you want.

## Conventions Used in This Book

We use the following conventions throughout the text to make everything consistent and easy to understand:

- ✓ All Web addresses appear in `monofont`.
- ✓ New terms appear in *italics* and are closely followed by an easy-to-understand definition.
- ✓ **Bold** text indicates keywords in bulleted lists or highlights the action parts of numbered steps.

We also include *spot-checks* in the Part III chapters to guide you in conversations with your contractor and help you make sure the construction process is going as planned.

## What You’re Not to Read

We’ve written this book so that you can easily find and understand information about building a custom home. Although you may be stuck on a deserted island and have plenty of time to read every word in this book, chances are you’re not. So, we simplify it so you can identify “skippable” material. This

information is the stuff that, although interesting and related to the topic at hand, isn't essential for you to know:

- ✔ **Text in sidebars:** The sidebars are the shaded boxes that appear here and there. They share fun facts, but nothing that's essential to the success of your project.
- ✔ **Anything with a Technical Stuff icon attached:** This information is interesting, but if you skip it, your custom house won't fall down.
- ✔ **The stuff on the copyright page:** No kidding. You can find nothing here of interest unless you're inexplicably enamored by legal language and Library of Congress numbers.

## *Foolish Assumptions*

We wrote this book with some thoughts about you in mind. Here's what we assume about you, our reader:

- ✔ You've been sketching custom homes on napkins or doodling floor plans during business meetings. You've looked at your current home with a critical eye and have, at least once, sighed and muttered the phrase, "Someday. . . ."
- ✔ You're drawn to home-improvement stores, television shows, and books.
- ✔ You're desperately looking for a comprehensive guide that demystifies the home-building process by focusing on the information important for you the homeowner to know.
- ✔ You're willing to do some soul-searching in order to get your custom home right. You (and any significant others you may have) have decided that the only way to get the perfect home is to start from scratch.
- ✔ You don't live in a "money-is-no-object" world. You want to make educated financial decisions regarding the budget and long-term financing of your custom home.
- ✔ You want to be involved with the process but you'll rely on professionals to help you when you need it. Professional help may come in the form of a financial advisor or loan officer, an architect or designer, a plumber, or a landscaper. You're willing to assess your strengths and weaknesses and seek help when necessary.
- ✔ We assume that you'll hire a contractor in some capacity, as most people do. (We do provide some small tidbits of information if you want to be your own owner-builder, but the majority of this book focuses on building a custom home with a contractor.)
- ✔ You have the ability to keep an open mind and consider new approaches and information, even when they seem at odds with what you've always been told about the custom home and financing processes.

## *How This Book Is Organized*

This book is divided into five parts. Jump in wherever you want! The following sections explain what you'll find where.

### *Part I: Getting Started: The 411 on Custom Home Building*

Get up to speed on the basics of building a custom home. In this part, you figure out how to get your project organized and how to find property to build on. You start to envision your home and define its style. You get to know the role of the architect or designer and obtain an overview of the plan-approval process.

### *Part II: All You Need Is Dough: Financing Your Custom Home*

Your project won't move from dream to reality without money. In this part, you can find the lowdown on using debt to your advantage and the construction loan process, including inside information on qualifying for the money you need to borrow. Read this part to understand why cash is king in getting your new home built.

### *Part III: Hammers and Nails: The Construction Process*

No, we don't expect you to build your own house with your own two hands. But wouldn't having some idea what those people are doing up on your roof or in your laundry room be nice? Find out the roles of the general contractor and the teams of subcontractors. Follow the construction process from excavation to framing to mechanical system installations to finish carpentry and beyond and use the provided spot-checks to make sure your contractor and subs are doing what they're supposed to do.

### *Part IV: All the After Stuff*

Just because the house is finished, you're not. Now it's time to plant and install your landscaping and, of course, move in. Also in this part, you see



that money is still an issue — you need to consider how to manage the investment you’ve made in your new home. Your construction loan is closed, but it may not be too early to consider refinancing.

## Part V: The Part of Tens

Like every *For Dummies* book, this part includes quick resources that provide plenty of information in an easy-to-digest fashion. Above all, this part shows that you aren’t alone. Gain wisdom from other homeowners’ trials and errors in the list of most common custom home mistakes and problems. Discover the best ways to lower construction costs. Use the list of best custom home resources to answer lingering questions or help you uncover wellsprings of useful information. We also provide an environmentally conscious list of ways to make your project green.

## Icons Used in This Book

To make this book easier to read and simpler to use, we include some icons in the margins that can help you find and fathom key ideas and information.



These tidbits provide expert advice to help you save time and money in the home-building process.



This icon highlights important information to store in your brain for quick recall at a later time.



Avoid mistakes by following the sage words of advice that appear under this icon.



Although this information may be fascinating, it’s not necessarily critical to your understanding the topic at hand. Feel free to skip it if you must.

## *Where to Go from Here*

The process of building a custom home isn't linear. Not everyone starts with the purchase of a piece of land, for instance. Some people go to an architect first to help them create a floor plan. Others may jump right in with both feet, and be halfway through construction before they realize they need to borrow money in order to finish.

So, to reflect the nonlinear process of building a custom home, this book is decidedly nonlinear as well. We organize it so that you can dip in wherever you want and still find complete information. If you've already bought land and met with an architect, but don't know how you're going to pay for the project, for instance, go to Chapter 7 to read up on financing. Not clear who does what on the job site? Flip to Chapter 11 for information on general contractors and subcontractors.

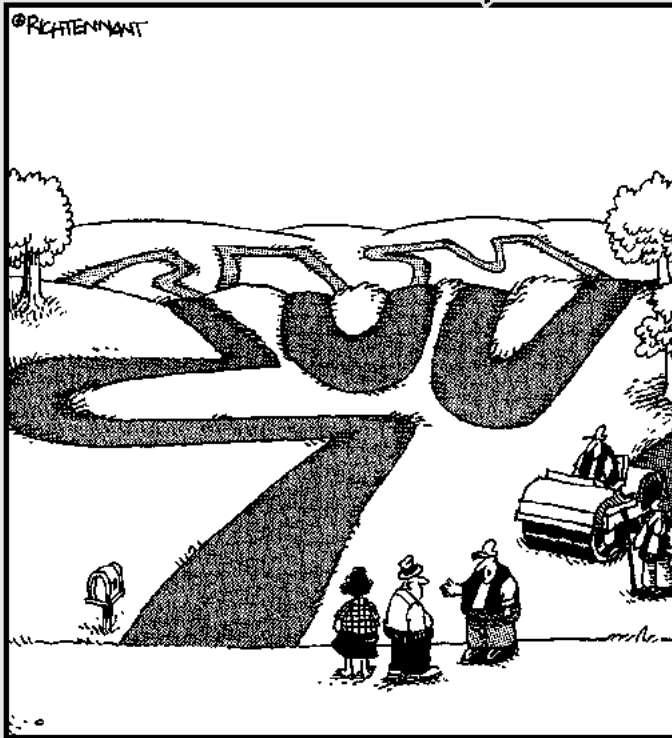
If you're not sure where to go first, you may want to start with Part I. It gives you all the basic information you need to understand the process of building a custom home. From there, you can skip to sections that cover the subjects that seem most fuzzy to you now. Rest assured that when you've finished that section, you'll have a better grip on home-building reality.

# Part I

# Getting Started: The 411 on Custom Home Building

The 5<sup>th</sup> Wave

By Rich Tennant



“Look, why don’t you and the Mrs. come to some final decision on where you want the house site, and then me and the fellows will come back and finish the driveway.”

## *In this part . . .*

**C**reating a custom home may be the biggest, most exciting project you have ever been involved in (yes, even more exciting than when you figured out static electricity in third-grade science class). As excited as you are though, you don't want to rush into it. In this part, we give you a general overview of what you're getting into. We also show you how to get organized and help you acquire land. Lastly, we help you decide on the type of home to build and walk you through the design and permit process with architects and designers.

## Chapter 1

# The Custom Home Process in a Nutshell

---

### *In This Chapter*

- ▶ Getting ready for the custom home process
  - ▶ Considering the finances
  - ▶ Figuring out who the players are
  - ▶ Understanding all the steps and time involved
- 

**M**ost people at some time in their lives desire owning a custom home. Some people are attracted to the thought of designing and creating something big from scratch. Others want to live in a new home that meets their specific needs instead of a house that looks like every other home on the block. Some people begin the custom home process by accident when they find a piece of land that inspires them.

More than 35 percent of new homes in the United States are custom homes. That means more than 300,000 custom homes are built every year. For each person building a custom home, five people are in the process of designing one. So you're in excellent company with many people dreaming about moving into a home designed and built just for them. Because custom homes are so popular, tons of resources are available to help you through the process.

But, like Rome, your new home won't be built in a day. The custom home process is lengthy, emotional, and expensive, without much consistency to it. Face it; custom homes require custom work and plenty of it! This work makes building a custom home challenging, and yet that extra work is what makes your project unique to you. You may feel overwhelmed at times, but by trusting in the experience of the professionals you engage in your project and keeping this invaluable book by your side, you can have a manageable project that delivers the custom home you have been dreaming of.

## *Where Do You Start? Preparing to Build Your Home*

Believe it or not, the custom home process really has no standard starting place. There are some logical entry points such as finding land, but most often people start with a designed house they've had in mind for a long time. Where you start isn't important; what is important is for you to make sure that you have taken all the necessary steps to give yourself the best chance for success. The following list includes some questions you need to consider before committing time and money to this project. We discuss some of these issues extensively in other chapters (which we reference for you here).

- ✓ Where do I want to live?
- ✓ How long do I want to live in this house?
- ✓ How will I find land? (See Chapter 3.)
- ✓ How much money do I have to spend on this project? (See Chapters 7, 8, and 9.)
- ✓ How much extra time do I have to put into this project? (See Chapter 2.)
- ✓ How do I find the right resources to design my house? (See Chapter 4.)
- ✓ How do I find the right resources to build my house? (See Chapters 2 and 11.)
- ✓ Is my marriage/relationship strong enough to survive this process? (See your clergy or shrink.)

Don't make the assumption that any one person can give you all the information you need to prepare for this process. Contractors have one perspective on the process, and architects may have a completely different perspective. Do your homework and interview as many people as you can who are or who have been involved in the process. By talking to professionals and consumers and asking them to share their experiences, you can begin to get a clearer picture of the process ahead.



Kevin recommends to all his clients that they get organized before beginning the process. Sit down and assess how much time you can put aside each week to focus on the project. Consider making a specific day each week your day for working on custom home stuff. Also clear a space in your office or den to be "Custom Home Central." This way you always know where to find what you need for your project. (You can find other organizing tips for your project in Chapter 2.)

## *Money Makes the World Go Round — Paying for Your Home*

We talk a lot about money in this book and with good reason. Custom homes require plenty of it. Your new home will probably be the most expensive item you have ever purchased. In fact, it may be the most expensive item you'll ever buy in your entire life. Custom homes cost more than production or tract homes because the materials aren't bought in quantities and the labor hired includes individual craftsmen. The results are worth it, however, and will last lifetimes.

Many people find it a challenge to get past the large checks they're writing. If you decide to use an architect, even the first check to the architect will probably exceed the biggest check you've ever written. The key to success with money in a custom home project is putting it in the right perspective. If your project costs \$500,000, then what each piece costs isn't important as long as it equals \$500,000 or less.



When you buy a new car, you don't argue over how much you spent for the alternator or the exhaust system. You look for the car to meet the price of your overall budget. Use the same logic when buying your custom home. Look for the best price on each item, but look at it in perspective to the entire budget. You'll do better on some items and worse on others, but if it fits your finances, then you're in good shape.

### *Asking yourself about affordability*

Of course you have heard horror stories about custom home projects that have gone seriously over budget. The projects go over budget for many reasons, but usually the main culprit is that the potential homeowners didn't spend enough time determining what they could afford. Obviously, if you're building well below your means, then going over budget is easily rectified by using your own cash. But running out of money is the No. 1 cause of custom home disasters. Before you start the custom home process, you seriously need to consider the following:

- **What can you physically pay?** Take stock of your cash on hand, equity in real estate, and available cash from other resources. Make a firm decision how much money you're willing to put toward the project. Chapter 7 can be a big help. You also need to get a rough idea of how much borrowing power you have to help establish a limit for your budget when added to your available cash. We provide tools and Kevin's expert financing assessments in Chapters 8 and 9.

- ✔ **What can you emotionally pay?** Just because you have the money and the borrowing power doesn't mean you really want to spend it all. Think carefully and discuss with your spouse what your limits are for making payments and how much *liquidity* (or cash) you need in the bank to help you sleep at night when all is said and done. Make sure you take into account tax deductions and interest earned on investments when analyzing your monthly cash flow. After you have found that emotional limit, you can design your project to fit your comfort zone.
- ✔ **What is your cushion and tolerance for risk?** Like we say again and again throughout this book, building a custom home is a complex process. You need to consider many variables beyond your control, and then realize that the project can go over budget even if you do everything right. You can certainly get good solid estimates, but ultimately you won't know what this home will cost until it's finished and you total up the receipts. Make sure you have addressed the "what if?" issues thoroughly. Talk about how you'll cover things financially if the market turns sour — devaluing your property — or the cost of materials rise. Decide what safety money (such as your 401(k) or retirement fund) you're willing or unwilling to tap into.



The more you talk about financial issues related to your custom home project, the more likely you are to resolve problems before they happen. Optimism in a custom home project can get you into trouble every time. The best approach is to examine every possible risk and make contingency plans for every potential problem.

## *Them that has the gold makes the rules: If you finance, the bank will dictate process*

Most people don't have all the money for a custom home sitting in their bank account. Even if they did, putting it all into the project wouldn't be a good idea, as we explain in Chapter 7. Like it or not, you'll probably have a financial partner in this project in the form of a construction lender or bank. The good news is construction lenders have the same objectives you do.

- ✔ They want to make loans for custom home projects. (That's how they make money.)
- ✔ They want the house to be completed on time.
- ✔ They want the house to be completed on budget.
- ✔ They want the house to be completed in a workmanlike manner.



Furthermore, the following tidbits can save you some arguments and frustrations when working with construction lenders:

- ✔ They don't believe a house is worth exactly what it costs.
- ✔ A larger loan makes you a riskier borrower, not a better customer.
- ✔ You aren't entitled to any loan.
- ✔ They aren't required by law to loan you any money.
- ✔ They dictate how the money is handled throughout the process.

Accept the fact that if you want to use a lender's money, you have to play by its rules. Most of these rules weren't made arbitrarily. They're designed to protect the financial viability of the project and protect the lender in the unlikely event of a *foreclosure*, which is the act of taking back the home in case you default on the payments or the construction contract. The guidelines and procedures are based upon statistical and anecdotal problems and failures that occurred with the lender in the past. Unfortunately, sometimes you pay for the sins of those before you.



Put yourself in the lender's shoes. If you were loaning a friend 80 percent of the money to build his home, you would want a few protections in place and a little control over the money as well, right? If you get to know how lenders see the project, which we explain in detail in Chapters 8 and 9, you can easily navigate the approval process as well as the funding process (see Chapter 10). This approach can make for a smoother, happier custom home project.

## *Introducing the Custom Home Life Cycle*

The first step to beginning the process is looking at all the pieces and how they go together. Your new home has a number of individual projects and transactions necessary to complete it. Your new home also needs an army of people with their expert work and services. This section breaks down in an approximate order each person required to get through the process. Then we outline each step necessary to go from land to landscaping.

### *It takes (more than) two to tango — A quick guide to the players*

The following list is a guide to all the individual players involved in the custom home process. You may or may not use them all; their roles can vary

depending on your region and your project's scope. The order of need may also change depending upon where you start in your process.

- ✔ **Financial planner and/or certified public accountant (CPA):** If possible, start the custom home process by carefully assessing your finances; a financial planner or CPA can help make sure you can afford this project.
- ✔ **Real estate agent:** You may need a real estate agent to help you find and purchase a lot, as we discuss in Chapter 3. She also plays a role when it's time to sell your existing home.
- ✔ **Loan officer:** Your loan officer needs to be involved throughout the entire process. You may need to start with a refinance or credit line to get liquid, as we discuss in Chapter 7. You want to finance the land (see Chapter 3) and do it consistent with the construction financing (see Chapters 8 and 9). Finally, you still may need another refinance after the project (see Chapter 16). Your loan office can help you through these steps. Lucky for you, Chapter 8 has good advice on picking the right loan officer.
- ✔ **Developer or landowner:** The land you buy has to come from somewhere. If you're buying in a subdivision from a developer, you may deal with a sales office. Or you may end up buying from a landowner that has had the property for generations.
- ✔ **Escrow officer or attorney:** Your state determines who administers the closing of your escrow, but either way, this person makes sure the title papers and insurance are all ready for you to take ownership.
- ✔ **Architect and/or designer:** Architects and designers design and draft plans for the house. Architects are licensed; they'll coordinate technical specifications for the house that may be beyond the scope of a designer. The architect can also guide you through the permitting process. (Chapter 5 can help you decide if you need an architect, and Chapter 6 provides the ins and outs of the permitting process.)
- ✔ **Log or timber frame dealer:** If you're building a kit home (see Chapter 4), you'll work with your dealer for the design process as well as the purchase of your materials package.
- ✔ **Contractor/builder:** You need to decide whether you need this person or if you'll rely on yourself to drive the construction of your new home (see the "Being an Owner-Builder: More Power to You!" section, later in this chapter, if you may want to be your own owner-builder). We give you tools for working with your contractor in Chapter 11.
- ✔ **Surveyor:** This person makes sure you know where your land begins and ends — a necessity for designing the house.
- ✔ **Soils engineer:** In many states, such as California, your foundation depends upon the report issued by this person.
- ✔ **Well/septic engineer:** If you're building in a rural area, you need this person to design and certify your water and sewage systems.

- ✔ **Planning department:** Your house needs to meet your neighborhood's zoning requirements before you get permits. This department enforces the zoning. (See Chapter 6 for details.)
- ✔ **Design review committee:** You can't always build what you want. This committee dictates what it wants to see in your design. (Look in Chapter 6 for more information.)
- ✔ **Building department:** Everything must meet code, and this department checks your plans before issuing permits. (See Chapter 6.)
- ✔ **Appraiser:** The lender won't approve a construction loan without an appraisal estimating the finished value. (Check out Chapter 9 for more information.)
- ✔ **Insurance agent:** Chapter 2 spells out all the insurance you need for the project. This person provides the goods — he'll be busy.
- ✔ **Material suppliers:** Sticks and stones all have to come from somewhere. Some projects have many sources. (See Chapter 11.)
- ✔ **Subcontractors:** Each one is an expert . . . just ask them. Artisans and craftspeople build each different system in your house. Chapter 11 tells you how to work with them. Chapters 12, 13, and 14 explain what they do.
- ✔ **Laborers:** Somebody has to do the grunt work on the job. These guys and gals work the hardest and get paid the least.
- ✔ **Building inspectors:** The building department checks up at various stages of construction to see that you're building in line with regulations. (Look in Chapter 11 for more details.)
- ✔ **Disbursement agents:** The lender assigns someone to make sure you get money when you need it or to solve problems with getting money from the lender. (You can find more on these agents in Chapter 10.)
- ✔ **Bank inspectors:** The bank won't give you money unless work has been done. These people come out to the property monthly or at various stages to make sure the work is complete. (Chapter 11 has more.)
- ✔ **Landscaper:** Usually the last part to go in but sometimes the landscaper designs the landscaping at the beginning. This person makes the yard green with your green. (Check out Chapter 17 for more info.)
- ✔ **Mover:** After all this work and trouble, the last thing you want to do is make 20 trips with the minivan. Let the movers do the work for you. (Turn to Chapter 15 for specifics.)
- ✔ **Decorator:** If you have any money left at the end, you'll have plenty of furnishings to spend it on. An interior decorator can help.

Although your architect or contractor may manage some of these relationships, ultimately you'll need to coordinate all these people in order to complete the project. You're going to meet many new people in this process, so put on your best smile and get ready to shake a lot of hands.

## *So many tasks, so little time — 50 steps to a custom home*

You're probably wondering why the custom home process has so many people involved. The simple answer: A custom home process has tons of tasks that need to be done. Although each home-building process may have some variation in the stages based upon factors such as location and weather, for the most part, the process moves in a step-by-step fashion.

The following list shows how a typical custom home process moves forward. The chapter references direct you to detailed discussions later in the book.

1. Decide you're ready to tackle the custom home process. (See Chapter 2.)
2. Meet with financial experts and get organized. (See Chapter 2.)
3. Prepare cash flow with financing on your existing house. (See Chapter 2.)
4. Find land and make an offer. (See Chapter 3.)
5. Obtain land financing. (See Chapter 3.)
6. Close escrow on the lot. (See Chapter 3.)
7. Get surveys and soil reports. (See Chapter 3.)
8. Get well and septic approvals if required. (See Chapter 6.)
9. Interview and pick an architect, if applicable. (See Chapter 5.)
10. Create the house's preliminary design. (See Chapter 5.)
11. Get zoning and design review approval. (See Chapter 5.)
12. Pick all your fixtures and materials. (See Chapter 5.)
13. Submit the plans for building approval. (See Chapter 5.)
14. Make the required plan changes. (See Chapter 5.)
15. Put the plans out to bid with contractors. (See Chapter 2.)
16. Interview and choose a contractor. (See Chapter 2.)
17. Apply for a construction loan. (See Chapters 8 and 9.)
18. Get an appraisal based on future value. (See Chapter 9.)
19. Get final approval for permits and pay fees. (See Chapter 6.)
20. Close escrow on the construction loan. (See Chapter 8.)
21. Set up disbursement account. (See Chapter 10.)
22. Set up communications with contractor and subs. (See Chapter 11.)

23. Prepare the building site for work. (See Chapter 12.)
24. Grade and/or excavate the property. (See Chapter 12.)
25. Trench for foundation, water, and sewer. (See Chapter 12.)
26. Pour the concrete for foundation and let cure. (See Chapter 12.)
27. Frame the exterior. (See Chapter 13.)
28. Frame the interior. (See Chapter 13.)
29. Install the windows. (See Chapter 13.)
30. Install the fireplaces. (See Chapter 13.)
31. Install the rough HVAC. (See Chapter 13.)
32. Install the rough plumbing. (See Chapter 13.)
33. Install the rough electrical. (See Chapter 13.)
34. Install the roof. (See Chapter 13.)
35. Install the outer sheathing. (See Chapter 13.)
36. Apply the exterior siding or stucco and paint. (See Chapter 14.)
37. Install the drywall. (See Chapter 14.)
38. Install the cabinetry and millwork. (See Chapter 14.)
39. Install tile, counters, moldings, and finish carpentry. (See Chapter 14.)
40. Install the doors. (See Chapter 14.)
41. Paint the interior and finish woodwork. (See Chapter 14.)
42. Install the plumbing fixtures. (See Chapter 14.)
43. Install the electrical fixtures and hardware. (See Chapter 14.)
44. Install the flooring. (See Chapter 14.)
45. Request the final loan disbursement. (See Chapter 15.)
46. Request final inspection and receive certificate of occupancy. (See Chapter 15.)
47. Roll to permanent financing. (See Chapter 16.)
48. Install the landscaping, including deck, pool, spa, and so on. (See Chapter 17.)
49. Sell your old house. (See Chapter 15.)
50. Move in. (See Chapter 15.)

Figure 1-1 shows photos taken through a number of stages to give you an idea of what a home in progress looks like.

**Figure 1-1:** A house in progressive stages of construction. From site prep through foundation, framing, and exterior work, this home took more than eight months to build.



*Courtesy of Aaron Rosenbaum*

## *Patience is a virtue — A true timeline for building your home*

Asking how long it takes to build a custom home from start to finish is a bit like asking the question “How long is a piece of string?” The obvious answer of course is “It depends.” So many factors can affect the time frame that the overall project can stretch from six months to six years. Kevin often has clients who come to his office asking if they can move in by Christmas, to which he always responds, “Absolutely, as long as you don’t care which year!”

Over the years we’ve seen patterns for the time it takes to complete each phase. The main point is to be flexible. You want to have a house you love for the rest of your life rather than years of regret because you rushed everything. Here are some typical rough timelines for the process based on Kevin’s 20 years’ of experience.

- ✔ **Land acquisition:** This step depends upon the availability of land in the area you desire. Land is hard to find, so pinpointing the exact time is difficult. Most of Kevin’s clients look for land for three to nine months before finding something they like. Purchasing the land, including the escrow and due diligence periods, can take anywhere from 30 days to six months.

- ✔ **Home design and approval process:** This stage mostly depends on how picky you are and your financing considerations. Local government efficiencies can play a factor as well. Figure at least three months. The design and approval process requires that everything goes perfectly and you can quickly make your choices. Kevin has projects that have taken more than two years to get through this phase.
- ✔ **Construction:** This stage covers the project's scope and the availability of labor. You can use the construction lenders as a guide. Most lenders provide 12-month construction loans. Smaller houses or *kit homes* (homes where all materials are supplied as a kit, such as log homes) may go up in six to nine months. Large detailed mansions may need 18 months.
- ✔ **Landscaping and move in:** This one is all up to you. After the house is complete, you can relax, although you may be required to finish landscaping in some neighborhoods within a year of completion. Most finish within six months.

## *Being an Owner-Builder: More Power to You!*

When you talk about building a custom home, people often assume you're planning on pounding hammers and nails yourself. Hardly anyone does the actual construction on their own custom home project. Many people, however, do consider acting as their own general contractor. Still, doing so is such a large undertaking that only about 20 percent of all custom homes are managed by *owner-builders*. In many of these cases, the owner is a contractor or already has some amount of construction experience. This factor isn't necessary, but it can make a big difference in the ultimate success of the project.

Even though the primary motivation for considering becoming an owner-builder may be saving money, the real issues to consider are time and management experience. This project will be one of the largest undertakings of your life, even with a contractor. Consider the following questions in exploring the owner-builder subject:

- ✔ How is my security at my current job?
- ✔ Do I have extra time and a flexible schedule?
- ✔ Can I make more money at my job with the time I spend on the home?
- ✔ Do I have a good understanding of the construction process?
- ✔ Do I have extra time to train myself on the process?
- ✔ Am I good at managing people and projects?
- ✔ Do I have a good eye for quality of construction?

- ✓ Do I have access to good resources?
- ✓ Am I good at problem solving?
- ✓ Am I good with multitasking and constant change?
- ✓ Am I well organized?
- ✓ Am I good at managing finances and budgets?
- ✓ Will my spouse and kids stay with me if I mess up the project?



If you honestly answered no to any of these questions, then you probably need to hire a contractor (see Chapters 2 and 11). Most owner-builders are gambling that they can do a job equal to or better than an experienced, licensed contractor, thereby saving the cost of that contractor. Although an owner-builder may end up saving money, you need to weigh the risk of that gamble against the money you might save. If you're wrong, it could cost you far more money than you planned to save in the first place.



One option if your answers were somewhat mixed is to hire an owner-builder consultant. One company called Ubuildit ([www.ubuildit.com](http://www.ubuildit.com)) offers expert consulting and procedures to guide you through the construction management process. The company charges you consulting fees and offers you products and services that are marked up, but the costs can be significantly less than a contractor's fees. Ubuildit is a good alternative for saving money and shortening the learning curve; however, you still need to have the time and the management skills to make for a successful project.

## *Analyzing the truth about savings*

The biggest motivation for being an owner-builder is the supposed savings. Ordinarily, a contractor makes money from charging a percentage on top of the cost of labor and materials used in the project; this fee or markup can be anywhere from 12 to 35 percent depending upon what and where you're building. Generally, more established contractors work on higher margins where younger contractors with less experience may work for less.



Where materials are concerned, the discount suppliers such as Home Depot have made construction supplies available to the consumer at contractor prices, which can be real savings if you're satisfied with the selection available at these stores. If you're building with more elaborate materials and fixtures, the contractor may have access to wholesale pricing that allows him to make some money without you having to pay more. In some cases he may be working on a lower margin and may be able to save you some money on items with a high retail markup.



With labor, you'll be subject to the prices and availability of the subcontractors in the marketplace. If the market is busy, pricing will reflect a direct supply-and-demand relationship, pushing prices up. If you have no preexisting relationships with any subs, you'll end up paying the full price for their time. If they're unable to work into your schedule, you may have other costs that come from delays on your project while waiting for the subs to become available.

## *Finding and managing subs*

Hiring and managing subs is the hardest part of being an owner-builder. Meanwhile, a contractor has the advantage of having long-term regular relationships with subs. An experienced contractor has spent years finding framers, plumbers, carpenters, and others whom he trusts to be timely, efficient, and good craftsmen. If they've worked together for a long time, they know how to work together, and the contractor will know when to ask for favors.



Hiring each sub is a new experience in negotiation, management, and quality control. Overcommunicate with everyone on the job to keep it running smoothly. Keep your eyes open. You probably won't know if you picked the right sub until she is finished and she has been paid. (Check out Chapter 11 for more information about working with subs.)

## *Financing implications*

One other challenge with being an owner-builder is the financing. Most conventional construction lenders frown on owner-builder projects. They have three basic reasons for being concerned:

- ✓ The bank is afraid the project might not be managed effectively causing it to exceed the allotted time frame and budget.
- ✓ The bank wants to be sure your job and income won't be negatively impacted by the time demands of this project.
- ✓ In case of foreclosure, the bank doesn't want to have to find and hire a contractor to finish the home.

For these reasons, many banks who lend to owner-builders do so with stricter requirements than for regular construction loans, such as loaning less money relative to appraised value or requiring full income documentation. Others

allow owner-builder financing only if you're a general contractor, or at the very least they require someone with construction experience as a site supervisor. Private sources for owner-builder construction loans are available, but they can be expensive and don't generally have permanent loans attached like the single-close loans we recommend in Chapter 8.

## Chapter 2

# Preparing for the Process

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### *In This Chapter*

- ▶ Creating organizational systems
  - ▶ Building a budget
  - ▶ Selecting a contractor
  - ▶ Purchasing insurance
  - ▶ Making an enjoyable experience
- 

**A**ny time you undertake a multistep project, you have a greater risk of something going out of control. The good news is that you can prepare yourself for the chaos and craziness that is bound to happen in your construction project.

In this chapter, we help you set up some simple systems for managing the people and tasks involved in the custom home process. We walk you through a short analysis of your finances so you can create a budget. We take you through the decision process of selecting a contractor and also help you to understand your insurance needs for the project. Finally, we provide you with several tips on how to keep the project a happy experience.

## *Organizing and Documenting*

The custom home process is chock-full of enough paperwork and procedures guaranteed to give bureaucrats chills. Now is the time to be honest with yourself. Are you truly an organized person? If so, this section is simply a series of reminders and ideas for you to embrace. If not, don't get intimidated by the challenges ahead of you. Find someone in your family who is organized or even hire someone to help you prepare for the large organizing task ahead. One good resource is the National Association of Professional Organizers at [www.napo.net](http://www.napo.net). You can also check out Wiley's *Organizing For Dummies* by Eileen Roth and Elizabeth Miles.

## *Building a workbook and portable file system*

To start with a difficult project like you're thinking of undertaking, you need a central place to store all the original paperwork you're about to accumulate. Because each transaction creates its own set of paperwork, you want to get organized or else you'll end up drowning in all that paper. A typical construction project usually generates enough paperwork to fill a two-drawer file cabinet. You not only need to store all this paperwork, but you'll also need to easily retrieve it throughout the process. Use the following suggestions for setting up categories for your filing system:

- ✓ Architecture and design
- ✓ Contractor communication
- ✓ Contracts
- ✓ Financing
- ✓ Invoices
- ✓ Land purchase
- ✓ Materials information
- ✓ Paid receipts
- ✓ Permits and approvals
- ✓ Subcontractor communication
- ✓ Warrantees



Many people start out with a single notebook and find out it fills up very quickly. We recommend using a permanent and portable system instead. Utilize the following efficient, step-by-step method for having pertinent information at your fingertips whether you're at home, in your office, or at your construction site:

- 1. Create a loose-leaf binder with dividers for the categories in the previous bulleted list.**
- 2. Decide after looking at each document whether you may need it at the site. If so, make a copy.**
- 3. File one copy in your file system at home.**
- 4. Place the other copy in your binder in the corresponding category to the home file system.**
- 5. Review your binder each day, adding the necessary documents from your file system.**

More and more people in the construction industry are using e-mail for communication. People collaborating on your project can easily pass along and share invoices, designs, pictures, and memos via e-mail. The great thing about e-mails is that they're easy to store without taking up any space in your file cabinet. If you use Microsoft Outlook or Lotus Notes, you can set up different folders for all the subjects and people you communicate with. This way you can easily reference prior communication and share it if needed. If you don't currently use e-mail, take the time now to figure it out. Doing so can make your custom home project run more smoothly. (Check out *Outlook 2003 For Dummies* by Bill Dyszel, published by Wiley, for help setting up and figuring out how to e-mail.)

## ***Calendar and communication — Your PDA is your friend***

Keeping your project on schedule is a major project in itself. You and your contractor need to coordinate all the actions in a construction project. For example, your electrical systems can't be installed until the framing is complete, and the house can't be framed until the foundation is installed. With so many people dependent upon the time frame of others, you need a simple way to keep track of everything, even if your contractor is managing the schedule.



Proactive communication is probably the single most important factor for a successful custom home. Make yourself easily available with a mobile phone so your contractor or architect can reach you when she needs you. Be prepared to respond to messages promptly (otherwise, if your crew runs into a snag, the project could sit in limbo while your contractor waits for you to check in and return messages — costing you time and money). If you're a recluse or shy when it comes to dealing with people, you may need to adjust your lifestyle and contact-management approach until your project is completed.

Staying in close contact requires you have immediate portable access to phone numbers for your contractor, architect, loan officer, and other key players. For those of you electronically minded, you can utilize great techno tools to help you. A personal digital assistant (PDA) is a small handheld computer that can store all your phone numbers as well as your calendar. PDAs cost from \$100 to \$500 and can transfer information back and forth from your computer, which helps if you're communicating by e-mail or managing your calendar electronically. Both Palm ([www.palm.com](http://www.palm.com)) and Microsoft ([www.microsoft.com](http://www.microsoft.com)) make software that is compatible with most computers. You can take time to figure out how to use these devices by reading Wiley's *Palm For Dummies*, 2nd edition, by Bill Dyszel, or *Pocket PC For Dummies*, 2nd edition, by Brian Underdahl.

A number of phones are also available today that combine the functions of PDAs with a fully functional mobile telephone. They're pricier and bulkier than regular mobile phones, but they allow you to combine the functions of two units. Check with your local cellular phone provider for details.



If electronics aren't your thing, we highly recommend a Franklin Planner from [www.franklincovey.com](http://www.franklincovey.com). They come in many sizes that can also serve as your planning notebook. You can keep all your contact information, as well as your calendar, with a pencil and have it ready whenever you need it. And if you use a planner, your batteries will never go dead because — unlike PDAs and other portable electronic devices — planners don't use batteries!

## *Being the bean counter — Keeping track of your finances*

Even though you may have a contractor and bank involved, ultimately, the job of managing the finances falls on you. You need to keep track of every dollar spent as you go, or you could have a very unpleasant surprise — running out of money in the middle of the project.



We recommend setting up a separate bank account early on for everything construction related. Setting up this account can help remove confusion and allow for easier record keeping. Keeping a file for each vendor and tacking down invoices and receipts in chronological order also makes life easier when looking for something later. Loose papers become a nightmare when you need something quickly. (See the “Building a workbook and portable file system” section earlier in this chapter for specific tips on keeping the files organized.)

Managing the finances is an easier task (just like keeping your schedule organized) if you're computer literate. You could manage your finances with a simple bookkeeping ledger book, but you can keep track of money in and money out in all the different categories of the build smoothly and efficiently with the help of an accounting software program such as QuickBooks by Intuit ([www.quickbooks.com](http://www.quickbooks.com)). QuickBooks offers a special construction version designed for contractors that can serve your needs well. The version is a little pricey at a few hundred dollars, but that's a small price to pay for effective money management. Wiley's *QuickBooks For Dummies* by Stephen L. Nelson can guide you through the software quite nicely.

## *Shopping and sharing — Collecting material information*

The biggest assignment you have in this project is . . . to go shopping! You need to choose hundreds of items for this house, and the sooner you start saving pictures and catalogs the better. (We provide a basic list of choices to be made in Chapter 5.) Magazines, catalogs, and the Internet are your best bet for finding hardware and fixtures.



Electronic storage of pictures makes for easier communication with your architect and contractor. A scanner can be a useful tool for cataloguing pictures from magazines to store on your computer. Then you can e-mail the scanned images to your architect and contractor or burn the images to a CD and share the disc with them.

## *Budgeting Your Project*

A budget for a custom home project is a living breathing animal. It will grow and shrink many times before the house is finished. Okay, it usually grows more than it shrinks, but the point is that it changes — a lot! You do have to start somewhere. This section can help you create a preliminary budget to get started. (We also provide more specific budgeting help in Chapter 9 where we explain how a lender budgets your project. If you're financing this project through a lender, then the lender's budget takes precedence over yours, so you need to get the two in line as soon as possible.)

Budgeting at the beginning of the custom home process is a bit of a chicken-and-egg process. You have to balance out the cost of the house with what you can afford. The problem is that the house may require more money than you have, which you can't figure out until you design the house and so on. The best method is to evaluate the two issues separately and then work to a compromise.

## *Looking at your finances and cash flow*

Chances are your lender will heavily influence your budget by determining an amount to lend you. But just because the lender says you can afford a million dollars doesn't mean you're comfortable spending that much money or making those payments. The best way to create a budget you can live with is to work with your certified public accountant (CPA), financial advisor, and

loan officer to assess how all factors will impact your finances. Make sure you discuss and take into account the following:

- ✓ Cash on hand
- ✓ Capital gains issues
- ✓ Current tax bracket
- ✓ Diversification of assets
- ✓ Intended length of time owning the home
- ✓ Long-term investment strategy
- ✓ Property appreciation
- ✓ Tax deductions for interest and points

Armed with this information, you need to arrive at a comfortable payment that a loan officer or loan calculator can translate into a loan amount. You can find a variety of these calculators at [www.mortgage-calc.com](http://www.mortgage-calc.com).



The mortgage information set out by these calculation sites is basic information and doesn't totally apply to construction loan qualification. These sites can give you a rough estimate to work within preliminary stages, but you need to speak to a loan officer that is a qualified construction loan specialist to be assured you meet construction loan qualification. (You can find specific information for construction loan underwriting and for finding a loan officer in Chapters 8 and 9.)

After you have a loan amount, you need to account for the cash available. As we discuss in Chapter 7, you need a good amount of cash to run this project. You may not want to spend it all, but cash is your surest way of keeping a custom home project running smoothly. Don't forget to include money you can take out of your existing house through a credit line or refinance. After you have decided how much of your cash you want to spend without being reimbursed by the construction loan on your project, add it to your loan amount estimate for the total estimate of your custom home budget.



Just because you can afford a large budget doesn't mean that the property will support the amount you want to spend. Many other factors can impact your budget later in the process, such as requirements of your property and sales in your neighborhood. (We discuss these elements extensively in Chapters 3 and 5.)

## ***Defining “dollars per square foot”***

Many different people use the “dollars per square foot” term many different times during your home-building process. Interestingly enough, however, no one uses a specific widely accepted definition. A real estate agent may state



dollars per square foot as the sales price of the home divided by the square footage, including the land. A contractor may or may not include items such as permits or financing in his estimates of dollars per square foot. After you have bids, the term actually becomes meaningless, but during the early stages of your project, you need a common understanding of what it means.

To decipher your dollars per square foot quotes, you have to define dollars and square foot the same way for each person you work with. Then you can make sure everyone is on the same page in every relevant conversation. The following sections outline the approach Kevin takes with his clients.

### ***Step 1: Define square footage***

First, create a definition for “square foot.” *Square footage* for this purpose needs to include all living space enclosed by walls that is completely finished. Your definition of square footage needs to include the square footage for the following:

- ✓ Bathrooms
- ✓ Bedrooms/closets
- ✓ Den
- ✓ Dining room
- ✓ Family and great room
- ✓ Fully finished basement
- ✓ Guesthouse
- ✓ Hallways and entryways
- ✓ Home theater and/or game room
- ✓ Kitchen/laundry room/pantry

Add the square footage together, and this total serves as your definition of the total square footage. However, your definition of square footage doesn't include square footage for the following:

- ✓ Attached decks
- ✓ Garage
- ✓ Patios
- ✓ Unfinished basement
- ✓ Workshop buildings

### ***Step 2: Define dollars***

Now that you have a total square footage number, you need to define the dollars necessary in the budget to define dollars per square foot. You don't want

to include all the construction costs in this dollar amount; many costs need to be evaluated independently. The following are the costs that Kevin excludes from this part of the calculation:

- ✓ Financing
- ✓ *Hardscaping* (unattached decks, pools, fences, and so on)
- ✓ Land
- ✓ Landscaping
- ✓ *Soft costs* (permits, plans, and fees)

So what's included in your definition of the dollars? Mostly labor and materials construction costs for all the living space we mention in the "Step 1: Define square footage" section are included plus a few other construction costs such as the cost of

- ✓ Attached decks and patios
- ✓ Driveways
- ✓ The garage
- ✓ Unfinished basement space
- ✓ Walkways

Take all your cost estimates and add them together to create a total dollars number.

### ***Step 3: Calculating dollars per square foot***

As soon as you establish the total dollars number, divide the total dollars from Step 2 by the square footage number from Step 1 to establish your dollars per square foot. Easy, huh?

Alternatively, you can take your total dollars construction budget minus the excluded items from Step 2 and divide by the square footage number to determine how much per square foot you have available to spend.

For example, if you have a budget of \$350,000 for total dollars available and your square footage is 2,500 square feet, your budget would be \$140 per square foot. You could then tell a contractor that you can only spend \$140 per square foot for construction of the house not including land, soft costs, financing, hardscaping, and landscaping, but that price must include the garage, driveways, walkways, attached decks, and any unfinished space.

## *Using a budgeting template*

To put all this information together, Kevin's company, Stratford Financial, suggests a little template to make everything easier. You need to do your own research to fill in the spaces for your project, but the following is a sample preliminary budget for a typical custom home project that you can scratch out on any napkin.

### **Funds available**

Add your available cash and the loan amount for your total budget.

Cash	\$175,000
Loan amount	<u>\$650,000</u>
<b>Total budget</b>	<b>\$825,000</b>

### **Cost-to-build**

Add all your costs together for your total cost.

Land	\$200,000
Soft costs (permits plans and fees)	\$40,000
Hard costs (\$160 per 2,650 Sq. Ft.)	\$424,000
Financing	\$35,000
Landscaping	\$40,000
Hardscaping	<u>\$25,000</u>
<b>Total Cost</b>	<b>\$764,000</b>



This template can give you a starting point for budgeting, but you do need to educate yourself on each of these line items to get a real picture of your project's costs. (Check out the table of contents to see where we discuss each topic for more information.)

## *Hiring a Contractor*

Most people building a custom home end up hiring a general contractor to do the job. In fact, 80 percent of custom home projects have a general contractor involved in some capacity. Many people find great comfort in having someone with experience manage the job while they earn the money to pay for the project. If you're considering being an owner-builder and not using a contractor, check out Chapter 1 to see if you're truly up to the task.

Every contractor has a standard contract and practices she uses with her business. Remember that you have the right to negotiate and compromise on issues before entering into any contract. Of course, the contractor also has the right to decline the job.

There is no set time to engage your contractor as long as it's a minimum of 60 days before you start construction so she has time to get everything ready for the build. Many people opt to engage a contractor much earlier in the process so that the contractor is actively involved during the design process.

After you and your contractor establish a contract and you're on your way, you and the contractor need to work as a team to build your custom home. In this section, we look at the contractor selection process. (You can find more information on managing your contractor relationship in Chapter 11.)

## *Understanding the contractor's role*

In most cases, the contractor doesn't handle the hammer-and-nail part of your custom home project. Although some contractors may participate in parts of the actual construction, his primary job is to manage the workflow and project materials and make sure everything is happening in a timely and workmanship-type manner. The following list includes your contractor's major responsibilities:

- ✓ Obtain the final permits
- ✓ Manage the production schedule
- ✓ Source and buy the materials
- ✓ Hire and manage the subs
- ✓ Keep the site safe and clean
- ✓ Manage the inspections
- ✓ Manage the budget

- ✓ Keep the consumer informed
- ✓ Effect quality control
- ✓ Problem solve



Not every contractor will handle all these items. When you hire your contractor, discuss with her how much you'll handle yourself directly and what she'll handle. Good communication is the key to making sure that you don't waste any time or effort doubling up on tasks.

## Getting bids — Comparing apples to apples

If you didn't start the custom home process with a contractor in mind, you'll probably give your plans and specifications or *specs* to a few different contractors to get an estimate. This process is called putting your plans *out to bid*.

Finding contractors to bid on your project is as easy as asking friends and your architect for referrals. If they aren't providing names, you can drive through the neighborhood and look for construction signs on houses being built. The Internet is also a good resource. Simply type the name of your city and the word "contractor" into a search engine such as Yahoo! or Google. Dozens of referral sites pop up for you. If the building market is busy, you may have to work a little harder to find contractors who can bid in your time frame. You want at least three contractors to bid on your project if possible. The trick is making sure you can compare the bids to each other.

The best way to compare the bids is by making sure your plans are as complete as possible. In Chapter 5, we discuss doing all your design work and material selection before the bid process. This extra work can delay your project early on but is crucial for comparing truly accurate bids. For example, you want to compare prices on the same kitchen sink model numbers to see which contractor is charging a higher profit margin. Also, make sure the contractor has included his fees in his estimate. He may or may not break out his margin as a separate line item, but you need to know there won't be any surprise additions to the costs down the line.



Many contractors substitute an *allowance* for unspecified materials. So, for example, if you haven't picked your bathroom fixtures, one contractor may offer you a \$10,000 allowance. This amount may seem cheaper than a different contractor's \$15,000 estimate, but you have no way of knowing if the quality is comparable or who is taking a higher margin. Also, availability and the difficulty of installing certain materials can impact the time and, subsequently, the

cost of the project. The surest way to make sure that all bids are assuming the same materials and labor necessary is to specify all the materials required for the project *before* you put the plans and specs out to bid. Having all these decisions clearly made in the beginning helps to avoid ugly misunderstandings and surprises later in the project.

## *Evaluating a contractor's 3 Cs — Cost, craftsmanship, and compatibility*



Do you want a quick and easy guide to help you pick the right contractor? (Yes, of course you do, because you're reading a *For Dummies* book.) Kevin has been advising his clients for years to make their choice by examining the 3 Cs: Cost, craftsmanship, and compatibility.

✓ **Cost:** This one is obvious and, although important, it probably weighs the least in your decision for picking a contractor. The cost comparison becomes plain when the contractors return the bids. If you have handed them complete, detailed plans and specs, you need a clear picture who is working on the lowest margin or who has access to the lowest cost labor and materials.

✓ **Craftsmanship:** This part is important in the long term. You want to know that the house is built well and will offer you decades of enjoyable living. Don't confuse style and design with craftsmanship. A house can have a horrible floor plan with fantastic artisan work.

What's the best way to check on work quality? Look at other houses that the contractors built. Ask the contractor for a complete address list of homes he has built in addition to a list of references. Make sure you look at houses built ten years ago as well as newer ones. Remember, just as a car with 50,000 miles drives much differently than a new one, an older home lives much differently than a new one. Don't forget to talk to the people living in the houses to find out what problems, if any, they have experienced with their homes. Don't be afraid to knock on the door of homes built by the contractor that weren't on the reference list.

Also, don't forget to ask the contractor about his workmanship warranties. Warranties usually last for ten years, but can vary. See Chapter 15 for more on contractor warranties.



✓ **Compatibility:** This "C" is the most important aspect to consider, and yet the most difficult to identify. The hard part is first assessing who you are so you can pick the contractor that will work best with your style. For example, if you're a micromanager that plans on being involved in every aspect of the project, then you'll constantly butt heads with a contractor that also likes to micromanage his projects. You need a more relaxed contractor willing to let you make the decisions or second-guess his work. On the other hand, if you don't have the time to be involved in

the management, then someone with a relaxed attitude probably won't give you the sense of security you need — particularly if he is waiting for you every day to make decisions. Figure out what sort of experience is going to make you happiest and find the contractor that can meet your needs.



References from people you know are great, but people have different tastes and perspectives on quality and experience. Ask specific, open-ended questions about the experience that can paint you a clear picture of the contractor's personality. Just hearing that "It was a good experience" doesn't tell you much without knowing the reasons why.

## *Using expert interviewing techniques*

If you haven't hired project managers before, then hiring a contractor will be a completely new experience for you. Generally, the contractor is trying to sell you on himself for the job because that is his business. At the same time, you're trying to sell the contractor into taking your project because the price is right and you like his work or maybe the market is really busy right now. With everyone so anxious to get going, the important issues, such as compatibility, can get passed over — leading to tense problems and unmet expectations later in the project. You need to make sure you not only ask the right questions, but also use effective methods to get the answers you want. The following list includes some tried-and-true interviewing techniques that are guaranteed to help you find the best contractor for your job:

- ✓ **Let the contractor do the talking.** If you're doing more than 25 percent of the talking, then you're the one being interviewed. Let the contractor explain to you why he wants this job. Have a standard list of questions for each interview that allows the contractor to tell you what he's like to work with and what services he provides. (We provide just such a list on the Cheat Sheet at the front of this book.)
- ✓ **Let the contractor tell you what he wants.** If you ask "yes-or-no" questions about his style and needs, he'll surely try to answer based on what he thinks you're looking for. Instead, ask him open-ended questions about his ideal project and the worst project he has ever had. Delve into details about his likes and dislikes. You'll be working with him for at least six months on this project, and nothing is worse than an unhappy contractor.
- ✓ **Give him problem scenarios.** Anyone can run a project that goes perfectly smooth all the time. You want to know how he deals with problem situations. Create stories of nightmare situations and ask him how he would handle them. For example, what if the framer and the plumber get into an argument, and one walks off the job before the job is finished? If he quakes in his boots with the questions, you'll know he doesn't have the strength to manage your project.



This project is your home, and your lifesavings are at stake. Compromise is okay to a point, but you need to have a good building experience to enjoy your home fully when you finally move in. Don't assume that contractors are all the same. Pick the one that makes you feel comfortable and secure and then communicate, communicate, communicate.

## Identifying Insurance Issues

If you arrange outside financing for your project, the lender requires insurance to cover several issues, including at minimum

- ✓ Liability
- ✓ Workers' compensation
- ✓ Course of construction

Even if you finance the project 100 percent out of your own pocket, you still want to protect yourself. This section outlines the different insurance policies necessary to protect your project and yourself. Don't wait to discuss these policies with your insurance agent. Not all carriers have these policies available, so you may need extra time to find a carrier and shop for the best price.

### *Liability policy*

Lenders require *liability insurance*, which protects you against someone getting hurt on the property or by the actions of somebody working on the property, to be carried by either you or the contractor. If the contractor carries the policy, the policy needs to meet the following criteria to satisfy most lenders:

- ✓ It must be in the form of a comprehensive general policy for \$1 million or the loan amount, whichever is greater, or be a policy including broad-form liability endorsement.
- ✓ The contractor must be named as the insured.
- ✓ You and the lender must be named as additional insured.
- ✓ The property address must be included on the certificate.

You may want to carry this policy yourself because in some states it can be expensive for a contractor to get a liability policy if he doesn't already have



one. If you carry the policy, the cost will be added to your budget and considered for financing as discussed in Chapter 8. Note that policies vary in cost by state and the size of your home. If you're carrying the policy or are an owner-builder, then you can get the liability policy with a few changes:

- ✔ The contractor doesn't need to be named.
- ✔ You're named as the insured.
- ✔ The amounts change to \$500,000 for each occurrence, extended to both property and personal injury or the loan amount, whichever is greater.

## *Workers' compensation*

Ordinarily, the contractor carries a workers' compensation policy if she has employees. You can ask to see the certificate because the lender will as well. In many cases, however, the contractor doesn't have her own employees and hires her labor and subs as independent contractors. If so, then these independent contractors fall under your liability policy in case of an accident. Lenders usually allow for this situation by having you and the contractor sign a waiver so the lender isn't held liable for any workers' compensation violations.

## *Course of construction policy*

This policy protects you in case of theft, fire, weather, or other damage to the house while it's being built. So if, for example, your plumber drops his torch and burns down the framing, this policy pays for the cost of rebuilding the house to its previous condition before the damage. Lenders absolutely require this policy to be in place before they fund loans. The cost of this policy varies depending on your state and the size of your home. The following criteria needs to be included in a course of construction policy:

- ✔ Coverage must be in an amount equal to the estimated replacement value of the improvements to be built or the loan amount, whichever is lower. Guaranteed replacement is usually acceptable instead of a specific dollar amount.
- ✔ The borrower is the named insured.
- ✔ The lender is named as the "mortgage and certificate holder."
- ✔ There is a 438BFU Lender's Loss Payable Endorsement naming the lender as the "Loss Payee."
- ✔ The property address and/or legal description is listed on the insurance certificate.
- ✔ The maturity date on the insurance is at least one day beyond the end of the construction loan term.

## *Managing Your Expectations*

One of Kevin's favorite contractors earned the "favorite" title because he is the biggest pessimist around. The problem with being optimistic with a construction project is that you're constantly disappointed. Materials don't show up on time or the sub takes longer than you thought to finish; you name it, it probably will happen. A custom home project is a journey with a life of its own. You can follow along and guide it, but you can tightly control only a relatively small portion of it. The best approach is to be well prepared, relax, and enjoy the ride.

### *Planning a timeline — A custom home is forever (So what's the hurry?)*

In Chapter 1, we show you a list of all the actions and people involved in the custom home process. The actual time frames for this process can vary based upon the size and scope of the project as well as the city or town you are building in.



In order to make the planning process go as smoothly as possible, talk to a couple of architects and contractors early to get a sense of how long everything normally takes in your area. Write down each step and the expected time frame. Now fold up that paper and stick it in your file. This paper is a guideline for you to refer to now and again only as a reference. You can fully expect for some tasks to take longer than you estimated.



A house is built to last decades. You don't want to rush a complex process, such as design or construction, to the point where corners are being cut. An extra month or so may cause inconvenience and may even cost a little money, but in the end you'll have a better-constructed home and you'll have forgotten about that delay after you've lived in the house for a year or two. That being said, you definitely need to monitor the schedule and time frames. Pay special attention to deadlines associated with the building department and your lender. But use your best judgment and apply pressure only when it's necessary. Your project is a working environment filled with plenty of stress. Overreaction and constant pressure on the workers can make them less likely to help your project move along smoothly.

### *Making hard choices — What you can (and can't) afford*

Most custom home projects go over their original budget — some more than others. You really have no way of knowing how much your project will cost

until it's actually finished. Until then, you have to constantly make choices to adjust your budget's expenses. Take a breather when making these decisions. Think about whether that gold-plated faucet really makes an important difference in your lifestyle. Sleep on it for a night or two. Find creative ways to make the home something you will enjoy while spending less money. We share some of our favorite ideas for saving dough in Chapter 19.



Give yourself a break. Design a house that doesn't stretch you to your limits. That way if you're coming in on budget, you can choose to upgrade and splurge here and there without worry. (See Chapter 5 for more tips on saving money when designing your house.)

## *Patience — Not everything must be perfect right away*

Many craftsman and artisans participate in the building of your custom home. If you've carefully hired everyone, you need to put your trust in these skilled workers. Many processes are multistage. Unfortunately, some people will make mistakes or leave some items partially finished. Don't panic; this process is normal. Your contractor and the subs can fix or replace most everything during the building process, and your contractor and subs do double-check their work as they go.



We give you spot-checks in the chapters in Part III of this book. Use them as a guide to check on everything along the way. Write down any concerns and problems you see. Rather than pointing out everything every time you have a concern, talk with your contractor and set up a meeting with the appropriate sub to share your findings. Doing so allows the subs to do their job with a minimum amount of pressure. You may find they had already scheduled the repair.

## **Keeping an eye on everything — Cameras on the property**

If you absolutely need to know what is happening with the property 24 hours a day, you may consider putting up cameras and broadcasting the signal to the Internet. Doing so is perfect for all you gadget geeks building custom homes. Internet sites such as [www.x10.com/cameras](http://www.x10.com/cameras) sell cameras and software that allow you to

watch the action at your build site from any computer connected to the Internet. You can expect to pay a couple of hundred dollars for all the equipment you need to watch your project 24 hours a day. You may find it isn't much different than watching paint dry, but what's a little boredom where peace of mind is concerned?

## *Making the process fun*

You're sure to have your share of frustrations and problems before your custom home is finished. Managing your patience and your temper is difficult when so many things are beyond your control and so much is at stake. To help you enjoy the lighter side of the process when everything is looking a little dim, we give you our top-10 list of ways to make your process extra fun:

- ✔ Enjoy a mud football game before the foundation goes in.
- ✔ Throw a block party at every completed stage.
- ✔ Have an office gambling pool on completion dates.
- ✔ Make matching T-shirts for all the workers on the project.
- ✔ Create art pieces with scrap lumber and supplies.
- ✔ Compile a construction hunk calendar.
- ✔ Give out a worker-of-the-month trophy.
- ✔ Put your family's handprints in the cement.
- ✔ During framing, fly paper airplanes off the second story.
- ✔ Make a photo album/scrapbook documenting the entire process.

## Chapter 3

# The Land Grab: Selecting the Perfect Site

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### *In This Chapter*

- ▶ Figuring out what a lot is
  - ▶ Making sure the property will work for you
  - ▶ Searching for (and finding) a lot
  - ▶ Estimating what a property is worth
  - ▶ Understanding tear-down properties
  - ▶ Purchasing the land
- 

**Y**ou can't have a house unless you have somewhere to put it. Unlike the pioneers of old, however, individuals today can't just walk up and squat on whatever piece of land that catches their eye. If you're interested in some land, you have to research, explore, negotiate for, and ultimately purchase a parcel that you can call home.

In this chapter, we walk you through the entire process of searching for and finding the perfect site. We provide you with the very best evaluation tips, and even discuss buying a house in poor condition that you can tear down and rebuild. Finally, we consider financing options. You have to pay for that dream property, after all!

## *Knowing the Difference between "Land" and a "Lot"*

Differentiating between some land and a lot may seem like an easy distinction. But not so fast. The two are in fact quite different. All lots can be considered land but not all pieces of land can be called lots. Are you scratching your head? If so, read on . . .

- ✓ A *lot* or *finished lot* is a piece of property that is ready for building a house. It may or may not have all the utilities (gas, electric, water, sewer, telephone, and so on) at the site, however, they usually aren't far away.
- ✓ *Land* is a catchall term that people in the construction industry use for any piece of property without a finished, habitable structure. Land can be commercial, residential, or agricultural. *Raw land* or *undeveloped land* is terminology that most people in the construction industry usually use, referring to land that isn't ready for building.



If you're anxious to get your new home built or if your finances are limited, then plan to buy a finished lot, not raw land. You can find a good loan more easily with a lot, you'll likely pay a lower down payment, and you'll have to spend less to prepare the property for building — all resulting in major savings in both time and money.

Raw land can be more difficult or more expensive to finance because it usually requires additional work (often, *significant* additional work), such as putting in roads and utilities, before building can begin. Fewer buyers are willing to put the time and effort into this type of property, which makes it less marketable than finished lots. As a result, fewer banks will be willing to lend you the money you need — you may have to find private financing or encourage the seller to loan you the money (referred to as having the seller *carry back paper*). If you do find a lender, you'll probably need to make a larger down payment. In most communities, noninstitutional individuals invest money in real estate — banks usually know these people. (See “Using private or hard money” later in this chapter for more information.)

Also, if you buy raw land, plan to allow yourself more time to complete the entire project because preparing raw land into a finished lot — getting approvals and permits, building roads, extending utilities to the lot, drilling wells, if necessary, and more — can take months or even years. Make sure you consider the extra time when discussing the term of your lot loan with the seller or private lender.

## ***Location, Location, Location — Refining Your Lot-Buying Needs***

Of course you don't want to buy just any lot. You want a lot that meets with your desires and will retain its value, if not appreciate.

Several criteria can affect the sales price of different properties both today and when your house is finished. Picking the right lot is just like picking a finished house. Factors such as location and amenities can make a lot undesirable. If a

lot is undesirable to you, it may be undesirable to others as well, which can have an effect on the marketability of the property and, ultimately, the resale value. Consider many factors when deciding on the right location for your lot.

The following sections contain some questions to ask yourself. When answering them, take into account not only your own lifestyle, but also the factors that will impact your ability to resell the finished house. Remember, use this checklist when searching for the right neighborhood as well as when evaluating a prospective lot for sale.

### ***Lifestyle***

You need to decide how you want to live in your home — these elements are a matter of personal taste. Many of the lifestyle items in the following list may be important to some of you and unimportant to others:

- ✓ Should the lot be in an urban, suburban, or rural area?
- ✓ Should the lot be flat or sloped?
- ✓ Should the lot have much usable land?
- ✓ Will the lot require significant ongoing maintenance?
- ✓ Should the lot be in close proximity to the neighbors?
- ✓ Should it afford privacy?
- ✓ Should it be sunny or shady?
- ✓ Should the lot have natural vegetation?
- ✓ Should the lot have available on-street parking?

### ***Marketability***

The list that follows has a variety of factors that impact value, and you need to use these factors when evaluating a lot to purchase. Keep in mind that you may have to sacrifice some of these factors, however, to meet your budget. Make sure you talk to a real estate professional to understand the market demand of a particular lot based on these issues.

- ✓ Is the lot on a busy street?
- ✓ What kind of view does the lot have?
- ✓ Does it have waterfront access?
- ✓ What is the proximity to power lines?
- ✓ Is it next to or near commercial buildings or apartments?
- ✓ What's the noise factor? How close is it to planes, trains, and automobiles?

- ✓ Is it on or near an earthquake fault or in a flood plain?
- ✓ Are there good schools in the area?
- ✓ What type of power, water, and sewage is available?
- ✓ What does city planning have in mind for this neighborhood?

## *Finding a Lot*

Acquiring the right lot may be the biggest challenge you'll face in the custom home-building process. Property values have been steadily increasing in most places since World War II, and not every piece of land will suit your particular needs or be cost effective for building. Finding the right lot isn't easy, and you need to plan for a long hunt. Some helpful resources are available, but not as many as you may think. Finding the right lot requires sleuthing and persistence. Your best resources are using the Internet, utilizing experienced real estate agents, and taking your own initiative.

## *Surfing for turf*

Using the Internet is a great way to start looking for your lot. The following Web sites are our three favorite picks for discovering your dream lot:

- ✓ [www.lotfinders.com](http://www.lotfinders.com): This site provides educational information on purchasing lots and connections to real estate agents that sell lots. Financing information is also available.
- ✓ [www.realtor.com](http://www.realtor.com): Owned by the National Association of Realtors, this site can show you every piece of land listed on the real estate bible: the Multiple Listing Service (MLS).
- ✓ [www.land.net](http://www.land.net): This site has listings for large parcels of agricultural and residential land as well as individual lots.

## *Engaging a real estate agent/lot specialist*

Finding a real estate agent that specializes in lots can be difficult and frustrating. Most agents don't want to spend the time with a buyer only to sell a piece of property at a fraction of the price (and a fraction of the commission) of a completed home; however, a few agents have made dealing with lots their specialty. Check to see if the real estate agent you're working with understands the issues associated with building, planning, and zoning that we reference in Chapter 5 as well as in this chapter. If your agent doesn't readily answer your questions and seems unsure, if you feel like you know more about these



topics from reading this book than she does, or if she brushes off or blows over your questions entirely, you may want to look for someone more experienced in lot sales. If your agent seems knowledgeable in lot-only sales, she can help you assess whether any potential problems associated with building on a particular lot may surface.



Even if you can't find an agent who focuses on lot sales, working with an experienced real estate agent at some point still may be in your best interest. Even though you may have to find the lot yourself, you still need help with the negotiations and transaction management. If the property is listed in the MLS, the seller is paying a commission of 3 to 5 percent to each agent anyway, so you may as well have an agent representing your best interest. Otherwise, the listing agent gets the entire commission just for representing the seller. (Check out Wiley Publishing's *Home Buying For Dummies*, 2nd edition, by Eric Tyson and Ray Brown for more info on real estate agents and their duties and commissions structure.)

## *Doing the legwork on your own*

If you want to find your perfect lot, you may have to do some detective work. Grab your sleuthing equipment and get started.



If you're looking for large tracts of custom lots, try the outlying areas of your city. Custom home developments often advertise in the supermarket real estate magazines, and new golf courses can make for a hotbed of lot subdivisions. Sometimes you can find the right lot simply by spending your Sundays driving through neighborhoods under development and looking for signs.

## *Finding a lot when there isn't one*

If you have searched online, worked with an agent, driven the neighborhoods, and still haven't found your dream lot for sale, you may need to take a more aggressive approach. If you find any piece of land you like, then contact the owner and make an offer! It doesn't matter that it isn't listed for sale right now. Remember, everything is for sale; it's only a matter of price. Information on who owns any piece of land is part of the county public record. Through a real estate agent, mortgage broker, or title company, you can request the address and phone number of the owner of any piece of land. If your real estate agent is managing your part of the transaction for a commission, she should be thrilled to help you with the negotiations and the closing process.



If you're willing to look at many pieces of land, you can take the shotgun approach. Have your agent get you a mailing list of all the lot owners in the area and send them all personal letters explaining your burning desire to own property and build in the neighborhood. Perhaps someone will consider selling his property and, if not, he may know someone in the neighborhood who may.

## Too bad it's not 1889!

In 1889, Oklahoma was emerging as a wealth of opportunity for settlers looking for land. Oklahoma Station and Guthrie Station were two promising railroad outposts destined for urban development. In one of the strangest and chaotic stories of land acquisition, the government created an exciting and unprecedented process for claiming land — a race! Rules were posted allowing people to gather at the nearby Arkansas and Texas borders ready to run, ride, and walk to their desired parcel of land on

April 22, 1889. Upon arriving at their parcel, they would claim it by staking a flag and filing a claim form. People already in the territory (“Legal Sooners” as they were called) would cheat by staking their flags early even though prohibited by law. Thousands raced that day and made Oklahoma land their home. It was exhilarating and brutal. “It is an astonishing thing,” the *New York Herald* observed on the eve of the opening, “that men will fight harder for \$500 worth of land than they will for \$10,000 in money.”

## *Evaluating a Particular Lot — The True Value of Dirt*

Although it may be true that the value of something is based upon what someone is willing to pay for it, land value has other factors to consider when determining its ultimate usefulness for building a custom home. You need to take into consideration the cost of getting the land ready for the build. You also must factor in limitations on the size of the home.

When determining a particular piece of property's value, a lender's appraiser looks at other comparable land sales in the area to create a number for the lender's purposes. Keep in mind, however, that this appraisal doesn't guarantee your ability to resell the land for the same price. Nor does it mean that your custom home budget will be able to absorb the price of the land. Consider all the factors associated with your build — especially financing — before purchasing a lot. Chapters 8 and 9 can help with understanding how lenders evaluate your land in relationship to the entire custom home project.

## *Examining amenities and utilities*

The relationship between utilities and your lot can have a significant impact on the lot's value. A lot requiring a septic system can add costs (which may decrease its value). The need to drill a well or to add offsite additions, such as sidewalks and parkways, can also negatively impact a lot's value. Be sure to explore the cost of installing utilities and amenities before you buy any lot.

This section contains some “due diligence” items for you to consider when figuring the ultimate “cost” of your lot. Ask these questions of the seller and your agent, or research them with the appropriate county or city agency. Then create a list of all possible costs to prepare for your budget and estimate how long it will take to work through the permitting or approval process. Here is short list of questions to ask:

- ✓ Does your lot require gravel, asphalt, or concrete for its driveway?
- ✓ Will you need to install sidewalks?
- ✓ Will you need to install street lighting?
- ✓ Will the lot require extensive earth moving or a special foundation?
- ✓ How far is the electricity from the build site, and how much will it cost to extend it to your property?
- ✓ What is the cost of connecting to the sewer or installing a septic system?
- ✓ Will the property support a required septic system?
- ✓ What is the cost of connecting to water or installing a well?



Many people get so caught up in the dream of building a house that they sell themselves into impractical situations. Keep your cool and do your homework. Buying a piece of land without researching all the issues and costs can leave you with a crushed dream *and* a useless piece of land.

## *Zoning in on zoning's limitations*

Nearly every city and county attaches building restrictions to land when the land is first put into development. This is called *zoning*. Zoning determines many factors you must consider, including

- ✓ The type of building you can put on the land
- ✓ The lot's minimum size
- ✓ The number of dwellings or units you can build on the lot

Finding out and understanding the zoning of a particular lot before you decide to buy is important. The information is readily available at your friendly, local city hall or county government building; your local government also has a guide that can tell you what each zoning designation means.



Most urban and suburban lots for houses are zoned residential R-1. If a zoning designation has a higher number, you can build more units on it (for example, a duplex or triplex) based on whatever number is designated (R-2, R-3, and so on). Some commercial lots can be used for residential, but the rules vary

among municipalities. Most large, rural properties are designated RA for Residential Agricultural. When the zoning has a number such as RA-5, the designation means your lot must be at least 5 acres in size. This information is important to know in case you want to split the property into more than one lot. If you have 9 acres with RA-5 zoning, you can't divide the lot in two. (Remember, each lot needs to be at least 5 acres.) You could split a 10-acre parcel in two, providing it meets all other county zoning guidelines.

Don't take today's zoning for granted — the local government can zone to meet with the needs of the community on almost a moment's notice and without your agreement or even advance knowledge. Although this change happens mostly in rural areas, check with the local government to see if any zoning questions for your area are scheduled. While you're at it, be sure to ask if any special tax assessments will affect the property. These assessments can add to your expenses as well.



Even though you can in theory build a single-family residence on a lot zoned for commercial or apartment use, you may want to take the zoning into long-term consideration. Often, a property owner may destroy a small house in a commercial area and build apartments or office buildings, which could change the neighborhood's tone for the worse (think noisy neighbors and cars parked everywhere), reducing your home's value.



Zoning only affects the general plans for the property. More detailed restrictions for building may also be stated in the covenants, conditions, and restrictions (CC&Rs) that are recorded on the property as well as design review guidelines. We talk more about CC&Rs and design review guidelines in Chapter 5. Ask the homeowners' association (HOA), your real estate agent, or title company for a set of CC&Rs and design review guidelines to find out about other restrictions, such as setback limits, style limitations, and height limits, before you agree to purchase any lot.

## *Understanding setbacks and footprints*

*Setbacks* determine how far from the edges of your lot you must build. They're generally determined by the property zoning restrictions and the CC&Rs. The side setbacks are generally closer to the property line than the front and rear setbacks, but not always. This information is crucial for figuring out where you can place the house on the lot. Many neighborhoods like to keep the houses uniform, so look to see how close neighbors' houses are to the street and each other to get a feel for the setbacks. In urban areas, the side setbacks may be as small as only a few feet (Peter's old house in San Diego had a side setback of only 3 feet — barely enough room to wheel his trashcan through to the street every Monday night). Rural areas can require larger setbacks from the street or other houses, impacting curb appeal.

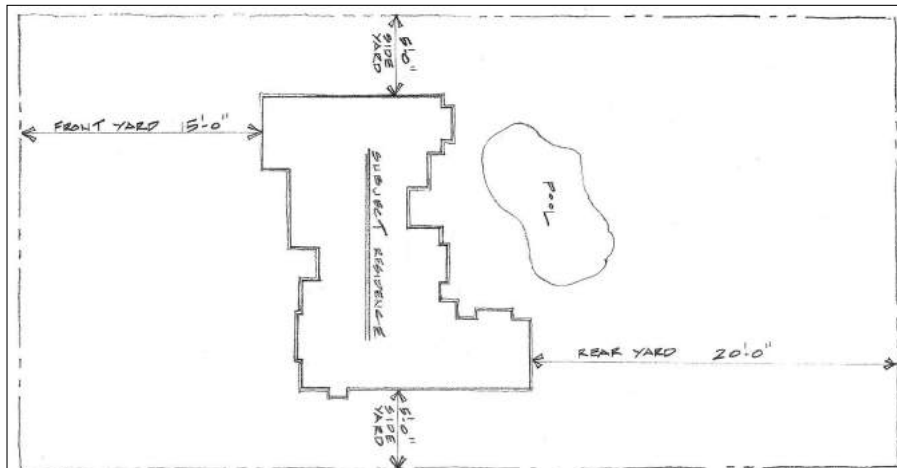


Setbacks also apply to outbuildings, not just to the main house. On larger lots, you may be considering the possibility of guest homes, workshops, and pool houses within the buildable area. These buildings all have to be within a certain area defined by the setbacks.

The *footprint* of the home is the building's outer perimeter and how it sits upon the lot, taking into account the setbacks (see Figure 3-1). When looking at a lot, try to imagine in rough design how positioning the footprint can take advantage of the following:

- ✓ Drainage
- ✓ Noise
- ✓ Sunlight
- ✓ Topography
- ✓ Views
- ✓ Wind

**Figure 3-1:** Setbacks determine the placement of your footprint, ultimately restricting your home's size.



Courtesy of Tecta Associates Architects, San Francisco

The combination of footprint and setbacks may dictate whether your house is one story or more. Significant side setbacks can force you to design a smaller footprint home, which can make a difference in estimating building costs. A smaller building area may mean building a second floor is essential. Building

a second story can work to your advantage, however, because a two-story house can be less expensive to build than a one-story home. (For example, building a two-story house with 4,000 square feet is cheaper than building a one-story house with the same square feet. The two-story house requires less excavation, foundation, and roof work than the one-story house.)

Height restrictions spelled out in the CC&Rs have an impact on your house's size. If your setbacks force a smaller footprint, then your height restriction will limit the size of house you can build. Have your real estate agent obtain this information for you *before* you purchase the lot to make sure it meets your needs. You can also contact the local planning department to access the information yourself.

## *Size matters — Assessing the land's value with the house*

Even though much of the planning for your new home is considered in the design phase that we discuss in Chapter 5, considering the planned size of your house when purchasing the lot is important. You can't build any house you want on any lot. You'll probably face restrictions set by the city, county, and sometimes the market. Doing your homework on the limitations of what can be built on a lot can keep you from making costly mistakes.

How do you know for sure that the land you want to buy is going to fit within your budget? You must consider it in the context of the budget for your entire custom home-building project. (See Chapter 2 for information on budgeting.) Start by researching the sale prices of houses in the area. If homes in the neighborhood are selling for \$500,000, then buying a comparable lot for \$375,000 isn't likely to leave you with financial room to build.



Still not sure what to do? Here's Kevin's quick-and-dirty four-step process for getting a rough idea if a lot is too expensive:

- 1. Contact a real estate agent and get a list of properties that have sold in the area during the last year.**

Make sure the list includes the square footage and room count of each home.

- 2. Pick the three sale prices that are most similar to the house in square footage and room count that you want to build and average the sales prices.**

Most lenders use at least three comparable sales to establish an appraised value, so this number helps you evaluate the property from the lender's perspective. If no home sales are similar to your desired home in square footage and room count, then you may need to reassess your design or your choice of neighborhood.

**3. Subtract the land price from the average sales price and divide by the square footage you want to build.**

Doing so gives you a rough number for *dollars per square foot*. We explain dollars per square foot in detail in Chapter 2.

**4. Call three contractors in the area and ask if they can build for the dollars per square foot number you established in Step 3.**

The contractors you call at this point can be referrals or out of the phone book. Where you locate them doesn't really matter because you may not use them for your project anyway, you simply want a rough survey. For more information on contractor selection, check out Chapter 2.

Taking these steps can give you a rough idea if you're even close. This method, of course, does have many variables and unanswered questions, such as the selection of your fixtures and materials and foundational needs. However, if all three contractors you contact are rolling on the floor with laughter, then you're probably looking at an overpriced lot.

## *A tale of two lot buyers — How square footage impacts value*

Kevin relates this experience from a custom home project he financed in northern California.

Ten newly divided lots were being sold for \$200,000 in an established neighborhood. Frank Smith looked at one of the lots and was concerned because he thought the lot was too expensive. He was absolutely right. Mark Jones came in the same day and looked at the same lot and quickly determined the lot was a great deal. He was also absolutely right.

How can they both be right if they're talking about the same lot? The decision is all about the square footage. Frank wanted to build a 2,500-square-foot house, which was comparable to other houses in the neighborhood selling for \$400,000. The total cost of the house including the land penciled out to \$450,000, making the project too expensive to build on this lot. Frank wouldn't be able to borrow enough money to build his house.

Mark's house was going to be 4,500 square feet. His cost per square foot was the same as Frank's so his total cost for the project including land would be

\$650,000. Houses of *this* size in the same neighborhood were selling for \$700,000, allowing Mark a \$50,000 profit on his house, which allowed Mark to borrow plenty of money to build his house.



Your real estate agent can show you the sales from the last year to evaluate the optimal house for your neighborhood, which can help you make sound choices for maximum value and the best financing.

## *Dealing with a Tear-Down Property*

Buying vacant land isn't the only option for locating a custom home. Many people opt to buy a small or dilapidated house and tear it down or add to it significantly. Doing so can be an excellent way to move into a new home but still have all the benefits of an established neighborhood.

### *Accounting for demolition costs*

One immediate cost benefit to a tear down is the fact that all the utilities are already located on the property and connected, which can be a great cost savings, but you still have an old house connected to them. Contact a demolition contractor and get an estimate for the demolition and clearing of the property before you sign on the dotted line.



Demolishing an older home may have additional costs due to the removal of hazardous waste such as asbestos (often located in roof, ceilings, or siding). Professionals need to remove asbestos, which can be costly.



Leaving one or two walls of the old home standing may be cost effective and worthwhile. Why not tear everything down and start fresh? Because many cities or counties offer a lower property tax rate for a remodel versus new construction. Depending on your community's rules and regulations, leaving one or two existing walls establishes the project as a remodel and can save you thousands of dollars a year.

### *Assessing neighborhood tolerance*

When you rebuild in an established neighborhood, you want to make sure the house conforms to the neighborhood. This action is critical to ensure a marketable property in the future. If you decide to locate your 3,000-square-foot home in a tract of 1,500-square-foot homes, you'll never get the value you want out of your home. The neighborhood needs to support the value. Underbuilding can also be a problem because people looking to buy in the neighborhood will expect a comparably sized house.





Most established neighborhoods require community approval of any major remodels. The local planning department generally notifies the community, and residents have the opportunity to voice their opinions — good or bad. Some areas have a specific design review committee that has a significant say in what you can and can't build.

Do your research and build a house that fits within the neighborhood tolerance or find another neighborhood that has houses closer to your desires and needs. You can find more information on the design review process in Chapter 5.

## *Financing pros and cons*

You may also encounter financing advantages if you buy a house that needs to be remodeled instead of buying a lot. If the house is still structurally sound, you may be able to buy the house with little or no down payment, while a house with structural problems can create financing problems. Most banks don't lend money on a house that is in functional disrepair (if you default on your loan, the last thing the bank wants is to be the proud owner of a hunk of junk). Buying such houses requires a lot of cash or private money, which can be expensive. Even then, a large down payment is necessary.

Small houses on large parcels of land can also be a problem in neighborhoods where bigger houses are now being built. Lenders want to finance houses for living. House lenders want a property that conforms to the neighborhood, even if the borrower is well qualified. Many people, when faced with unwilling house lenders, look to lenders that lend on land only. If the property has any structure on it at all, most land lenders won't provide a land loan. Talk to your real estate agent and loan officer about the ability to lend on a particular property before you make an offer. Remember, the finished cost estimates of your project need to account for the purchase cost as well as the demolition cost in order to be realistic.



If you have found a structurally unsound house and a willing seller, you may be able to buy the home with a construction loan, which will finance the purchase of the property and the construction together based on the future completed value of the property. Chapters 8 and 9 explain in detail the construction loan process and guidelines. You can apply the same construction loan information in this book as if you were working with a vacant lot. Simply have your seller agree to a long escrow that allows you the necessary time to design and permit your new house. Most construction lenders can fund the purchase as part of the construction loan provided all their other guidelines are met.

## *Buying Your Land*

After you find your dream lot, you need to buy it. Whether you pay cash (a big no-no — Chapter 7 explains why) or finance, you can't just write the owner a check and ask for a receipt. Okay, you could, but you need to follow certain steps and make specific choices if you want to get the most for your money.

### *Understanding the purchase process*

If you have ever purchased a home, then you're at least somewhat familiar with the process of buying real estate. Buying a lot is just like buying a house, but without all the house stuff. You can find a detailed explanation of the purchase process and the players involved in Kevin's book *What the Banks Won't Tell You; How to Get the Most Out of Your Mortgage* (Grady Parsons Publishing), available at [www.stratfordfinancial.com](http://www.stratfordfinancial.com). For beginners, here is a general step-by-step look at the process.

#### *Step 1: Determine your offering terms and price*

Using the information in this chapter about evaluating a property, you need to determine a price in your mind of what you're willing to pay for the property. Your real estate agent can give you additional information on the local market for land and examples of finished houses in the area. If you aren't using an agent, you need to access this information through the local title company. You also must decide on the length of time until closing as well as any other necessary terms, such as your desire for the owner to loan you the money in what is called a *seller carry back*. This term means the seller, after transferring the property, retains a note or loan that you must pay him at an agreed time with interest. We talk more about this topic in the "Finding other land loan alternatives" section later in this chapter.

#### *Step 2: Present the offer and negotiate*

You or your real estate agent has to complete an offer form accompanied with some sort of good faith deposit check from you. The deposit amount can be anywhere from 1 to 3 percent of the purchase price. The check is deposited in an escrow account upon acceptance of the offer and held in escrow until you close the transaction. The offer and copy of the check are then presented to the seller and negotiations begin.

You and the seller can negotiate the deal through subsequent documents called *counter-offers*. The seller's willingness to negotiate is relative to how hot the real estate market is at the time. A hot market usually translates to less willingness to negotiate. The seller isn't obligated to accept any of your

terms and can always choose to say no. Of course, you can always choose to walk away. Ideally, you'll each give in a little and come up with a workable compromise. As Kevin's mom, a 30-year real estate agent veteran, said, "An offer is an opening of a conversation." The less emotions in the conversation, the easier the negotiations proceed.



If the property is listed with a real estate agent, that agent doesn't represent your interests. Make sure you bring your own agent to represent you as the buyer. Doing so doesn't cost you any more because the seller pays the commission. If no real estate agent is involved, consult one for guidance. She may help you with the paperwork for a small fee. You can always check with an attorney as well, but an attorney generally charges more and sometimes makes the transaction more complicated than it needs to be.

### ***Step 3: Make an application with your lender***

We explain various financing options in the next section. After you have determined which lending approach is right for you, you'll fill out a loan application with the lender of your choice. The lender orders an appraisal from a certified appraiser. You'll probably have to pay for this appraisal upfront. The cost can vary depending upon location and the lot's value, but usually it will cost between \$300 and \$600. You're entitled to a copy of this appraisal, which will be based upon comparable lots in the area that have sold in the last six months to a year. The original appraisal goes to the lender along with the application and any credit documentation you provide, such as bank statements, W-2s, and tax returns.

At this time, your lender will give you a good faith estimate (GFE) of all the closing costs associated with your loan and the purchase transaction. The costs vary based upon the loan amount and type of loan, but you can anticipate a range of 3 to 6 percent of the purchase price as an estimate of all the costs involved.



You can save the upfront cash for closing costs by offering to increase the price of the lot by 3 percent and then asking the seller to credit you 3 percent of the purchase price for nonrecurring closing costs. Most lenders accept this agreement as long as the appraiser mentions that it has no effect on the value. Financing the closing costs in this way leaves your cash available for other important costs along the way.

### ***Step 4: Open escrow with an escrow company or attorney***

The term *escrow* means depositing money and property with a neutral third party to be disbursed upon completion of all terms of a related agreement. Each state has its own process for escrow procedure. Some states use attorneys to act as the escrow agent and others use title insurance companies. If you're in a *wet funding* state, you, the seller, and the escrow agent all pick a

day to meet and sign the paperwork at one time. In a *dry funding* state, such as California, you each execute the paperwork on your own or with a notary public over several days before the actual closing date.



The escrow period can be anywhere from 30 days to 6 months depending upon the needs and negotiations of you and your seller. Your real estate agent helps guide you through the closing process. If you don't have an agent, then the escrow agent will be your best guide. You can find good escrow agents through referrals from real estate agents, loan officers, and friends. Most are well trained, so unless your transaction is extremely complicated, you should be able to go with someone you simply find personable.

### ***Step 5: Do your due diligence***

While you're in escrow, you have a chance to complete any research on the property that couldn't be done before the offer. In a hot market, you might not have had much time to research the property before putting in an offer. As soon as you have a chance, make sure that the property meets your needs relative to size and value as outlined in this chapter. If you have concerns about the land, such as building restrictions or guidelines, you may want to add contingencies to the offer that allow you to pull out of the transaction if your research results are unfavorable.

### ***Step 6: Execute the paperwork and bring in the money***

As soon as your loan is approved, you need to bring your cash to escrow and sign the loan documents. You can wire money into escrow or bring it in the form of a cashier's check. Bring your pen because you'll have as many as 100 documents to sign for the escrow and the loan.

### ***Step 7: Close escrow and take title***

The title insurance company provides you with a deed to the land and a policy insuring that it is yours. The title company pays the seller the money due and records any documents and deeds related to the transfer and new loan.

## ***Using the bank***

Most people finance their lot purchase through a local bank or nationwide lender. A good mortgage broker can help you determine who has the best programs to meet your needs. Local banks generally have more conservative criteria for loaning on land because they're heavily regulated. Large, publicly held lenders have the ability to offer creative and flexible loan programs because they mix the risk with other loans in their portfolio.

Not all mortgage brokers have experience with land and construction loans, so be picky. Don't trust the phone book on this one; ask around to find the experts. Try to find a loan officer that has 100 or more loans of these types under her belt. The best way to test loan officers is to see if they ask you more questions than you ask them. If they simply try to sell you on one type of loan without inquiring about your needs, then look for someone else to help with your loan needs.

### *Qualifying*

The first thing a lender will ask you is whether you intend to buy the land for your own personal use. The lot-financing rates and terms for owner-occupied properties are much better than for investment properties. The lender looks to see if it makes sense for you to move to this property. If you're claiming it to be a second home, the lender will expect it to be in a resort type area or a city other than your primary residence. Buying the lot in a cheaper neighborhood on the other side of town from where you currently live will raise eyebrows.

The lender next assesses your qualification on the basis of your credit report, *liquid assets* (cash, stock, or other easily accessible forms of money), and your *debt-to-income ratio* (the amount of debt you carry in the form of loans and credit card balances versus your income). Your lender's approach to these issues is very similar to how it will underwrite your construction loan; see Chapter 9 for the specifics. To make its decision, the lender wants to see, at minimum, the following documentation:

- ✓ Appraisal
- ✓ Credit report
- ✓ Three months' bank statements
- ✓ Two years' W-2s and recent pay stub
- ✓ Two years' tax returns, if self employed

Banks may loan you a higher percentage of the purchase price based upon the quality of your other qualifications. Being able to show good credit and sufficient income can get you a loan for 90 percent of the purchase price.

If you have excellent credit, some institutional banks such as Washington Mutual and IndyMac offer "stated income" programs for purchasing lots. These loans don't require you to show any income documents (pay stubs or tax returns). Some lenders offer these loans up to 85 percent of the purchase price; however, the income you state must make sense relative to your job. A fast-food clerk supposedly making \$150,000 a year isn't likely to get approved. You may need to show other documentation and meet other criteria necessary for these loans, so make sure you get the info from your loan officer before you apply. We give specific details on these types of loans in Chapter 8.



Many lot lenders are the same lenders that finance construction. You apply for a construction loan some months after you get the land. If the lender sees conflicting information regarding income or assets, the lender could turn you down. Therefore, understanding the requirements for lot loans and construction loans is critically important. (We explain construction loan requirements extensively in Chapter 9.) Lenders look in their files for any other loans they made to the same borrower. If the information is inconsistent, the lender simply rejects the loan.

Stated-income loans are notorious for creating consistency problems. Because a lot loan is usually a lower loan amount than a construction loan, less income is required to qualify. If you only state enough income to qualify for the lot loan, and then when you submit the construction loan application to the same lender you state a higher stated income amount, the lender will immediately deny the loan. Work with your loan officer to determine the qualifications necessary for the larger construction loan so you can represent the land loan file in a way that will match the construction loan needs. Chapters 8 and 9 can serve as a guide for that discussion.



One of the advantages of working with a mortgage broker is that she can act as a filter. By looking at your documentation, a good broker can determine which lender fits best with your project. Doing so keeps you from stabbing in the dark and providing too much information to the lender that may result in denial.

### ***Picking a loan***

The most important criteria for your loan is the loan's length of time. (We talk more about timing of lot loans in the section "Making sure the loan period is long enough" later in this chapter). Generally, your lot loan picks you based upon your qualifications. You may, however, need to choose between a *fixed-rate loan* or an *adjustable-rate loan*. Some lenders offer only fixed-rate loans where the interest rate stays the same for the loan's life. These rates are generally higher than adjustable-rate mortgages, which have interest rates that move with a particular monetary index such as government treasury bills.

Some people believe a fixed rate can save you money because it protects you from rising interest rates. But if you plan on building in the next few years, you'll be taking a construction loan that pays off the land loan. See Chapter 8 for details. Because you'll likely pay off the land loan soon with the construction loan, using a fixed-rate loan isn't likely to save you much money. Ultimately, you need to do the math and compare the various loan payment options over the length of time you anticipate before you start building.



Kevin's recommendation is to go with the largest amount of money you can borrow for the longest period of time with the lowest payment. Doing so gives you the most flexibility for moving into construction financing by keeping the maximum amount of cash in your pocket where you need it most.

### ***Getting denied — What the banks won't finance***

We can think of several situations that will eliminate conventional financing as an option. Some are based upon your own situation and some on the property. Here is a quick checklist:

- ✓ If your credit score is below 620 (see Chapter 9)
- ✓ If you have been late on your mortgage in the last 12 months
- ✓ If you're unemployed
- ✓ If you have no down payment
- ✓ If the property has existing buildings on it
- ✓ If the property is more than 50 acres (some banks allow only 20 acres)
- ✓ If the property has no electricity nearby
- ✓ If the property has no public access
- ✓ If the property has multiple parcels (some banks allow two)

If your property or qualifications fall into one of these categories, don't panic just yet. Other lending alternatives are available. Some may cost more money and be more restrictive than conventional lending, but they may be better than the thought of abandoning your project.

### ***Finding other land loan alternatives***

If you find the perfect lot and the bank thinks the property or your credit and income are less than perfect, you still may be able to buy it without paying all cash. Some lending alternatives are available if your property or credit doesn't meet the bank's guidelines.

#### ***Letting the owner carry the burden***

One alternative way to finance a property is to have the property owner loan you the money or *carry back paper*. In this case, the seller acts as the lender and has you (the buyer) execute a note secured by the property for the amount he doesn't receive in cash through escrow. Not every owner will consider this option. If the owner carries back the entire amount of the purchase price, the seller can't owe any money on the property. Another way a seller can help is to carry back a second loan so that you can put down a smaller down payment. The primary lender must agree to this arrangement. In either case, the seller has the ability to foreclose if you miss payments. You need your real estate agent or an attorney to draft the note and security instrument to make sure everyone is properly protected.

When is a seller more willing to carry the financing himself? A seller may agree to carry paper if the property is hard to finance through banks or if he — for

whatever reason — is anxious to sell. The seller may also want to defer the taxes due from the sale of the property; carrying paper allows the seller to pay taxes only as you pay off the loan. You gain no real advantage when the seller carries the financing unless the loan's terms are more favorable than any other lender offers you. Most construction lenders require the seller to be paid off when they fund the construction loan. Few institutional construction lenders allow a subordination of a seller carry.



Some sellers want a premium if they're going to carry paper. Furthermore, many sellers still want to check your financial wherewithal, so credit and income can still factor into their decision. Ultimately, you can negotiate the best deal with a seller if she is getting all the money expected from the escrow, so having her carry may not be the best route.

### ***Using private or hard money***

*Hard* money comes from private investors who specialize in making loans on real estate. Hard-money lenders generally aren't concerned with credit or income. They hope to make high-interest yields or make money by taking back your property through foreclosure and selling it at a profit. Typical hard-money runs a number of percentage points higher interest than the prevailing market rate, plus 5 percent of the loan amount in upfront fees called *points*. This high interest seems expensive, but if banks or owners won't give you a loan, then this choice may be better than not buying the lot at all. Because hard-money lenders like equity, they usually want as much as a 50 percent down payment.

## ***Making sure the loan period is long enough***

Lot loans come in a variety of lengths, but only a couple of banks offer them for more than five years. Your lot loan needs to be in place until the construction loan pays it off. Most projects can make it to the construction-loan phase within two to three years. If you think you're going to take a long time to design your home or that you'll need to save your money for a long time before beginning construction, then you may want to search for loans that last more than ten years.

How long it takes to begin the building process can vary wildly. The ultimate amount of time is based upon your local planning departments, how picky you are with your plans, how busy the current construction climate is, and many other factors. Figure out how long you think it will take and double it to be safe. Most of the delay factors will be beyond your control.



## ***Stop! Don't pay off your lot yet!***

Contractors, consumers, architects, and many others often tell you that you must pay off your lot before you get a construction loan. This is the biggest myth in the custom home–construction world. Actually paying off the lot isn't a good idea unless it's absolutely necessary. The following sections explain several good reasons to keep a loan on your land until you're ready to build.

### ***You need cash on hand to fund your project***

Buying your land is just the beginning of paying people in a construction project. The architect, the engineer, the well and septic people — and many others — need to be paid along the way. The permitting process can suck your cash as well. These people and processes can add up to tens of thousands of dollars. If you run out of money because you put all your hard-earned savings into your land, your new home can become a nightmare. Having cash in your pocket is your best protection for keeping your project moving along. Check out Chapter 7 for more on this subject.

### ***Money put in is expensive to get out***

Few lenders refinance a land loan; most only let you replace an existing loan. Rarely does a bank give you a loan where you're taking cash out of a piece of land. That means that after you put money into the land, it's gone forever — at least until your construction loan has started. Your only choice will probably be hard or private money, which can cost 5 percent of the loan upfront and 10 percent annually. This increase compared to institutional lot loan pricing is an expensive price to pay for money you already had in your pocket to begin with.

### ***Cash reserves are required for construction loans***

Banks want you to have cash on hand before they give you a loan. The amount of required reserves varies from bank to bank (see Chapter 9 for specific details). If you're short on the bank's cash requirements, it won't give you a loan — even with a paid-off lot.

### ***Fending off the taxman***

Real estate interest is one of the few deductions left for the average taxpayer. As long as you finish the house as a primary residence or second home, you should be able to deduct the interest and points paid on the loan. That means the government will pay a good portion of the payments for you to keep cash in your pocket. Discuss this option with your CPA or financial planner. You can ignore the tax benefits if you feel paying more than your share is part of your civic duty.



## Chapter 4

# Defining Your House Style

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### *In This Chapter*

- ▶ Discovering your style
  - ▶ Finding out about conventional building materials
  - ▶ Building with wood
  - ▶ Contemplating system-built homes
  - ▶ Exploring alternative building methods
- 

**P**eople tend to judge houses just like books — by their covers. Looks matter: People either fall in love at first sight or think a house is an eyesore. What individuals see is the home's style. That's why defining your home's look is so important, which is exactly what we help you do in this chapter.

You may have a truly unique home in mind — like one built of log or post-and-beam construction. This chapter offers more information on buying and building these specialized homes.

## *Getting to Know Your Style Preferences and Limitations*

Close your eyes and picture the outside of your ideal home. Often, a definite look pops into mind: a yellow farmhouse with white shutters and a front porch, a boxy glass and concrete contemporary, or maybe a brick colonial with classic trim and an unadorned face. If an image of the perfect house doesn't immediately come to you, get off the sofa, find your camera, and get ready to go hunting.

## *Educating your eye*

Get ready and get set to go on a house safari. It requires just a few hours, so you don't need to pack water or hire a guide. As you drive through neighborhoods, take pictures of homes that strike you — the good, the bad, and even the ugly. After you're back home with photos of a variety of house styles, you can consider what appeals to you and what doesn't.



If you can't find a variety of homes nearby to photograph or aren't impressed by the homes you come across, head to your local bookstore to stock up on a variety of magazines and books for inspiration. Look for

- ✓ General home magazines, such as *Architectural Digest*, *Better Homes & Gardens*, *House & Garden*, *Home*, *Country Home*, and *Country Living*
- ✓ Specialty home magazines, such as *Natural Home*, *American Bungalow*, *Old House Journal*, *Dwell*, log home magazines, timber frame home magazines, and Victorian-style magazines
- ✓ Regional magazines that cover your area, such as *Sunset*, *Southern Living*, *Down East*, *Midwest Living*, or *Coastal Living*
- ✓ Books that help you identify architectural styles, such as *What Style Is It? A Guide to American Architecture* by John C. Poppeliers (Wiley) or *A Field Guide to American Houses* by Virginia McAlester and Lee McAlester (Knopf)

As you flip through your new library of magazines and books, rip, clip, or photocopy photos that illustrate exterior details you like. Take note of what speaks to you: Is it a particular color or material? Window size, shape, or grouping? Shutters? Dormers or roof shape? Collect your clippings in a three-ring notebook or expanding file folder. Soon you can define your own personal style.

## *Discovering your local style*

Now breathe deeply and take a reality check. Maybe you've fallen for an Asian-inspired pagoda-style home with a flat roof. It may not be your best choice, however, if you plan to build in an area with heavy snowfalls (that is, unless you enjoy the thought of several tons of wet snow crashing through your roof). This appeal to common sense will lead you to another rich source of home style ideas: your area's traditional (or *vernacular*) architecture. To discover this style, take a look around and note how older homes were built.

Regional styles typically evolve as a sensible response to a local climate, making them wonderful guides for what kind of buildings will work and what

kind won't. Think about it: If that 200-year-old farmhouse down your street didn't know how to stand up to your region's weather, it wouldn't still be around today.



If you're moving to a new area to build your home, seek out the old-timers. In New England, for instance, the compact Cape Cod style home with its steep-pitched roof sheds snow and provides a snug second story under the roofline. These buildings offered warm shelter for early Americans living through harsh winters. Down south, in hotter climates, high ceilings in sprawling plantation homes lured warm air up and out of the way. Their wide porches gave folks a place to sit, eat, and often, sleep, outside.

Learning from years of building experience can help make your home easier to maintain and much more pleasant to live in. Employing vernacular architecture also provides the added advantage of making your home look like it belongs. Even if you want your custom home to be unique and make a bold-style statement, you don't want to own the neighborhood laughingstock either, and, at some point, you (or your heirs) will want to sell it. Then, your home's classic good looks will be a valuable asset.

Still, it's a free country, and if you live in Pennsylvania and really want a Southwest pueblo-style home with a flat roof and adobe walls (and you've ruled out a move to Arizona), you just have to be ready to pay more to build and maintain your home.

## *Playing by community rules*

If aesthetics or the wisdom of your ancestors doesn't influence you in defining your home's style, your neighborhood might — in the form of covenants, conditions, and restrictions (also known as CC&Rs). These legalities (which you must agree to as a part of your real estate contract) can significantly impact your home, so do your homework before buying land. If you really want a log home, a barn full of llamas out back, or a three-story home overlooking a lake, you better read the CC&Rs' fine print before you buy your lot. Policies set out by homeowners' associations or local jurisdictions could restrict many aspects of your home, such as

- ✓ The height and size of your building
- ✓ Its proximity to a body of water
- ✓ The building materials you can use and your home's exterior colors
- ✓ Your ability to raise livestock
- ✓ The types of vehicles that can be parked on-site

Obviously, know upfront what you're in for. Some associations strictly enforce their restrictions. Others are more lenient. The upside of these kinds of restrictions is that they apply both to you and to your neighbors. You can rest assured your neighborhood will retain its current standards and be free of worry that some guy across the street will make his front yard a dumping ground for derelict plumbing fixtures. If you don't like these kinds of rules and regulations, you'd better buy your land in a different neighborhood.



If you plan to build in a community with CC&Rs, an architectural review board may have to approve your home's design. Because this review process may take months, add extra time into your construction schedule. (We talk more about review boards and the plan approval process in Chapter 6.)

## *Tapping the wisdom of the pros*

So, you've looked at houses nearby, considered vernacular architecture, and flipped magazine pages until your fingers were raw, but still can't decide on a style. Think back to your house safari and remember the master: Marlin Perkins from TV's *Wild Kingdom*. When things got really dicey, wise old Marlin sent his sidekick, Jim, out to wrestle the wildebeests, while he stayed in the safety of the vehicle. Take a lesson from Marlin: Instead of risking a serious mistake, call for professional help. If you can't envision a style for your new home, or you and your spouse can't agree on a style, ask for input from an architect or designer. (See Chapter 5 for the specifics of finding and working with an architect.)

Your design pro will look at the scrapbook you have compiled and ask questions about your lifestyle. She may suggest a home style that's common to your area or make the case for something more unusual. During this design process, you can help by

- ✓ **Openly discussing your budget.** It wastes your time and the designer's if you hedge about how much you want to spend on your home.
- ✓ **Offering honest feedback.** If your designer seems to be veering off track, say so. The goal for everyone involved should be to create the best possible home.
- ✓ **Keeping an open mind.** Don't dismiss an architect's suggestions without giving them some consideration.

At some point in the process you'll wonder if hiring a designer or architect is necessary or worthwhile. The fees these professionals charge typically fall in the range of 10 to 15 percent of your project's total cost. If you can find a plan in a book that suits your needs as well as your lot and your neighborhood restrictions perfectly, you don't need an independent designer.

But remember those wildebeests: By not using a designer or architect, you're facing some wild times all by yourself. An architect or designer often can act as your advocate in a confrontation with a contractor. Because the designer's job is to be knowledgeable about building materials, he can save you from spending money on a product or material that simply won't work in your area or in your home. Furthermore, he can create a home that truly fits on the land you worked so hard to find.



Good communication and rapport are essential elements in your relationship with a design professional. If these two elements evaporate over the course of your project, you may need to cut ties with your building or design professional and choose someone new. This action is drastic, however, and should only be taken if you have honestly tried and simply can't reconcile your differences.

## Considering Conventional Construction: Wood versus Steel

By far, the most popular home construction technique is *conventional construction*, which uses vertical studs to create the home's skeletal system of both exterior and interior walls. Choosing conventional construction allows for a wide range of styles; the studs are simply the basic ingredient. The studs in your walls will be either *dimensional wood lumber* (lumber that has been cut to specific, standard sizes) or steel.

More than likely your house will be stick-built: It will use good old-fashioned wooden *studs* — long, thin boards used throughout the framing process. Wooden studs are popular because

- ✓ Most framers have the necessary tools (hammer, nail gun, saw, and so on) to work with wood.
- ✓ Wood is mass-produced and costs up to 30 percent less than steel.
- ✓ Most subcontractors and laborers know how to work with wood.
- ✓ You can alter wood-framed walls relatively easily in the future.

A second option — steel framing — has been in use for office buildings for some time now. For a variety of reasons, steel is finding its way into more residential construction projects. Although steel isn't for everybody, it does have a few advantages over wood:

- ✔ Steel offers the greatest strength for the lowest price of any building material.
- ✔ Steel is inorganic. Galvanized steel doesn't burn, warp, rot, split, crack, creep, or get eaten by termites and other creepy crawlers.
- ✔ Steel is dimensionally stable. It doesn't expand or contract due to moisture.
- ✔ With steel, you have less scrap and waste (2 percent for steel versus 20 percent for lumber).



For every person singing the praises of steel framing, another is swearing that wood is the only way to go. The benefits and disadvantages seem about equal for each method, so it comes down to what makes the most sense to you and your contractor, the price, the climate, and other considerations. After you find a contractor you like and who you can afford, ask for references and check out his work firsthand. Then we advise that you yield to your builder's preferences on the wood versus steel issue.

## Enjoying the Warmth of a Log Home

Everyone who has ever watched *Bonanza* or read a *Little House on the Prairie* book (come on, admit it!) has harbored a fantasy of living in a log home. For some, the fantasy is fleeting; for others it becomes a lifelong obsession.

Building a log home does bring a variety of advantages:

- ✔ You have a range of log home styles available to you. Logs can do justice to country, rustic, Victorian, Arts & Crafts, and even contemporary styles.
- ✔ You'll end up with a custom home that is distinct and filled with character.
- ✔ The thickness (also known as *thermal mass*) of logs offers good insulation and helps the home retain warmth in the winter and remain cool in the summer.
- ✔ Many log home owners say their homes are quieter inside than conventional homes.
- ✔ The rugged good looks of a log home make it fit naturally into a variety of settings, from prairie to woods and from lakeside to mountaintop.

But if you chose to build a log home, understand that you're asking for something out of the ordinary, which may cost you more than a conventionally built home in terms of time and money.





The following sections briefly outline how the log home–building process differs from the conventional building process and also provides advice on selecting a log producer if you decide to make your log home dream a reality. If you’re interested in a log home, we suggest that you continue your search for more information in several places:

- ✔ **Use your friendly, local bookstore or library.** Look for books and magazines on the subject. On the newsstand, look for *Log Home Living*, *Log Homes Illustrated*, *Country’s Best Log Homes*, and *Log and Timber Style*.
- ✔ **Stop by log model homes in your area.** Talk with the sales representatives and ask questions.
- ✔ **Knock on the doors of log homes you see.** Log home owners are typically quite happy to discuss their home–building experiences.
- ✔ **Talk to real estate agents, your lender, insurance agents, and local builders about your desire for a log home.** These building professionals may be able to point you in the right direction.
- ✔ **Finally, keep an eye out for the dozens of log home shows that are held around the country every year.** A show is a good place to see firsthand what various log home producers have to offer. (You can find information at [www.loghomeliving.com](http://www.loghomeliving.com) or [www.loghomeexpo.com](http://www.loghomeexpo.com).)

## Two ways to skin a log

As you research log home options, you’ll find two basic types of log producers. Most companies are *manufacturers* that mill their logs using machinery. The end result is logs that are uniform in shape and dimension. Manufacturers typically also use machinery to cut the corner notches that connect the logs. Many manufacturers offer log siding that can be used on a home’s exterior (and also on interior walls) to give the look of log construction with a slightly lower price tag. The remaining log companies call themselves *handcrafters*. As the name implies, these companies employ crew members who use chain saws, or sometimes even hand tools, to shape the logs for homes one at a time.

Which should you choose? As with so many decisions involving custom homes, the answer is, “It depends.” Consider the following:

- ✔ **Do you need your home fast?** Some handcrafters are tiny operations that produce only a few homes a year. If you want to build quickly, choose a larger production handcrafter or a manufacturer. Remember, though, that even these producers need weeks or months of lead time to cut your logs.
- ✔ **Do you prefer a certain style of log?** For some people, only square logs accented with wide bands of white *chinking* (the material used to seal

the joints between logs) look like a “true” log home. Other people prefer smaller, rounded logs with no chinking. You can see an example of milled logs in Figure 4-1. The look you like can help you decide on a producer.

- ✔ **How much log is enough?** Do you want massive, 20-inch diameter logs for your home and the interior partition walls, too? Most manufacturers’ machinery simply can’t handle oversize logs, so if you think bigger is better, you’ll most likely choose a handcrafter.
- ✔ **Will it play in your neighborhood?** If you plan to build in an area filled with log homes, consider following local traditions. Are most of the homes built with huge, handcrafted logs? Choosing smaller, machined logs may make your home the odd man out.
- ✔ **Can you pay for it?** Does a handcrafted home cost more than a manufactured home? Again, it depends on whom you ask. Handcrafted homes are preassembled in the crafters’ log yard, so reerection of the shell on the construction site may go faster, saving time and money. Still, handcrafting a log home is labor intensive; after all, you’re asking someone to build your home *by hand*. Manufactured logs may take longer to assemble on-site, but producing them is more mechanized (and less expensive). The only way to find out is to ask plenty of questions and compare ballpark estimates on your home from both types of producers.



**Figure 4-1:**  
This log home is made from milled logs interlocked together.

Courtesy of The Original Lincoln Logs LTD.



Thinking that logs are a money-saving, do-it-yourself alternative to a conventionally built home? Do your research. Even if you mastered your Lincoln Log kit at an early age and know which end of a chain saw to point toward a tree, buying logs from a supplier and planning to cut, notch, and stack them yourself may provide short-term savings at the cost of long-term headaches. Unless you have a sound plan (or know a builder who has good experience) to stack, fasten, and seal the logs into walls that will pass building codes and stand up to the elements year after year, buy a log package from a reputable log producer.

## *Purchasing your log package*

Most log manufacturers and some handcrafters sell log packages. A log package assembled by a log producer will most likely come with fasteners to hold the logs together, precut notches to interlock the logs at the corners, some kind of insulating material to place between the logs, sealants for weather-proofing, and instructions for your contractor (or you) to put it all together.

You can purchase most log packages through a network of dealers or local sales representatives. Your local representative can help you purchase your log package and, if she is a general contractor, may also help you build your home. As your liaison with the log producer, your dealer can help you with your home's design, coordinate the logs' delivery, and walk you through the purchasing and construction processes.



One major difference in the construction process occurs in the loan process. Understandably, log producers don't want to cut and process logs for your job without knowing that you're serious about building the home. For that reason, they ask for a large deposit (typically 50 percent of the package cost) before they cut the logs. The construction lender you choose must be willing to advance that sum from your total construction loan early in the process. (For more information on the construction lending process, see Chapter 10.)

After the log producer delivers the logs to your building site, the producer's crew or your general contractor's crew will stack them into walls. The home will take shape quickly, because after they're stacked, the logs create finished walls, both outside and inside. They don't need to be insulated, covered with drywall, or sided on the outside. Log homes do have some unique construction steps, but generally subcontractors working on a log home will proceed as they do on a home built with conventional construction.

## Highlighting Wood Inside — Timber Frame or Post-and-Beam

If you love the look of wood but not necessarily log homes, you may opt for a post-and-beam or timber frame home. Chances are you've seen this kind of building method used in old barns or churches. A frame of substantial, interlocking timbers supports timber homes. The timbers may be held together with pegged joinery cut out of the timbers themselves or fastened with bolts or metal plates. Unlike log homes, from the outside, timber frame or post-and-beam homes can look like any other home. Inside, the frame's beauty is revealed, adding character and wood tones to interior spaces. (See Figure 4-2.)

Timber framing is a new take on an old tradition that has several benefits:

- ✔ Timber framing creates a home with high energy efficiency. The energy efficiency comes with the method of enclosing the frame. Many timber frame companies suggest the use of structural insulated panels (SIPs) to wrap the frame in a continuous envelope of insulation.

**Figure 4-2:** The beauty of wood timbers is revealed on the home's interior where posts and beams allow for open, vaulted spaces.



*Courtesy of The Original Lincoln Logs LTD.*



## SIP: Building a better sandwich

Structural insulated panels (SIPs), which range in size from 4-x-8-foot rectangles to large 8-x-24-foot sheets, are “sandwiches” of expanded foam between sheets of plywood, oriented strand board (OSB), or other solid material such as drywall. SIP manufacturers bond the layers together using pressure and industrial adhesives. After they’re precision-formed in a factory, the panels are ready to be shipped as is, or the manufacturers’ crew can cut the panels to accommodate windows and doors. The panels’ plywood or OSB surfaces serve as the base for drywall or paneling in the home’s interior and

any common type of finish on the exterior, such as siding, brick, or wood shingles. During construction, electricians can run their wires through chases drilled in the panels’ foam or simply install wiring behind wall baseboards. To connect the SIPs to the frame, the installation crew spikes or fastens the panels to the timber frame, and then fastens them to each other. SIPs can be used for roofs and floors as well. SIP walls may cost a bit more than conventionally framed walls, but their increased energy efficiency should make up for any additional upfront cost.

- ✔ Timber framing, which has been practiced for centuries, uses large wood posts and beams that add plenty of character to a home.
- ✔ Through the use of trusses, timber framing can create homes with large open spaces that span great distances and accommodate the open floor plan that many homeowners desire.

As with log home construction, timber framing may add to a home’s bottom line. It’s a specialty home, after all. You may be able to recoup the extra money in energy savings over the life of the home and in a higher price set at resale.



To find out more about timber framing:

- ✔ **Go to your bookstore or library.** Look for books and magazines on the topic. Look for *Timber Homes Illustrated*, *Timber Frame Homes*, and *Log and Timber Style* magazines. Tedd Benson’s books, *Timberframe: The Art and Craft of the Post-and-Beam Home* and *Timber-Frame Home: Design, Construction, Finishing* (both by Taunton Press) are good starting points.
- ✔ **Search online for timber frame and post-and-beam companies to see photos and descriptions of their work.** Many companies sponsor open houses, workshops, or frame raisings that are open to the public.
- ✔ **Visit the companies’ model homes or homes of their previous clients to see framing in person.** Ask the representatives or homeowners questions.

- ✓ **Attend one of the dozens of log and timber frame home shows held each year around the country.** You can find information at [www.loghomeliving.com](http://www.loghomeliving.com), [www.timberframehomes.com](http://www.timberframehomes.com), [www.timberhomesillustrated.com](http://www.timberhomesillustrated.com), or [www.loghomeexpo.com](http://www.loghomeexpo.com).

As you research timber framing options, you'll find that several different kinds of companies offer timber frames and post-and-beam packages. Most packages contain the timbers for the frame, and oftentimes, the system to enclose the frame.

The style of the timbers can create or enhance a number of different styles, from Shaker style to Old World lodge to Arts & Crafts style to something more rustic. If you're an antiques lover, you might search out a timber producer that can supply timbers salvaged from old buildings or a complete frame from a former barn to give your new home a vintage feel.



If you're concerned that timber framing will bust your budget, opt for a *hybrid* home. In a hybrid, timber framing is used selectively, typically in large public areas, like great rooms, entryways, or dining rooms. Smaller rooms, utility spaces, and bedrooms can be built without timber framing to save money.

Along with cutting the timbers, and often raising them on-site, companies may offer additional services. Make sure you understand if your timber producer provides these kinds of services, or if you need to hire additional, local help to work on your project. The companies may

- ✓ Enclose the frame with SIPs, conventionally framed walls, or some other enclosure system
- ✓ Have a staff member who can design the frame or the entire home
- ✓ Serve as the general contractor for your home's construction from start to finish

In your research, you'll find that timber frame operations range in size. Some small companies concentrate on handcrafting just one or two frames a year. Other timber frame and post-and-beam companies produce many more homes annually and sell packages through sales representatives or dealers. Some of these representatives live or work in a model home. Your representative can help you purchase your timber frame or post-and-beam package, and, if he or she is a general contractor, may build your home. As your liaison with the company, your dealer can help you with your home's design, coordinate the frame's delivery, and explain the purchasing and construction processes.



One major difference in the timber home construction process occurs in the lending process. As with producers of log homes, a timber producer doesn't cut a frame without knowing you're serious about paying for it. For that reason, the producer will ask for a large deposit (typically 50 percent of the

package cost) before the timbers are cut. The construction lender you choose must advance that sum from your total construction loan early in the process. (For more information on construction lending, see Chapter 10.)

After delivering your timbers to your site, your timber producer's crew will assemble and raise the frame. The framer's crew, or your general contractor's crew, will then enclose the home and it will be considered "under roof" or "dried in." Although timber frame and post-and-beam houses have some unique construction steps, subcontractors working on these homes generally proceed as they do on a home built with conventional construction. As with other types of custom home construction, the general contractor typically supervises the entire timber home project from start to finish.

## Considering a System Approach

When you need new kitchen cabinetry, you usually don't ask a cabinetmaker to haul his tools, crew, and raw materials to your home to build cabinets for you on-site. You pick a style at a cabinet supplier's showroom and order the number and size you need. The supplier sends your order to the manufacturer, who goes about building your cabinets in a factory. You can apply these very same methods of production and delivery to building a home. Homes produced in a factory are called *system-built homes*.



Before visions of double-wides rusting in trailer parks come dancing into your head, you need to know that "trailer homes" are now labeled as "manufactured homes" and are built to a different code (known as "HUD code" for the Housing and Urban Development agency that writes it) than system-built homes (which are built to the same codes as site-built homes). System-built homes include both modular and panelized homes.

## Weighing your options

Today's factory-built or system-built homes come in many forms, but fall into two broad categories:

- ✓ **Modular home:** Built using preconstructed sections of the house, called *modules*
- ✓ **Panelized home:** Built using preconstructed wall, floor, or roofing units, as well as all other components of the house

Each form uses components that a supplier cuts to fit — and sometimes even assembles — and then delivers to the building site for completion.

Some companies specialize in creating large “chunks” of homes in their factories. These companies build panels or wall sections using conventional construction or SIPs that are made of layers of plywood or oriented strand board and foam. The panels may contain prehung doors or fully installed windows, and they’re shipped to the construction site to be joined together to create walls on the foundation.

Why would you choose to have your home prebuilt instead of built on your property? The question for many is, “Why wouldn’t you?” Some of the benefits include the following:

- ✔ System-built home plans are as flexible as conventional construction homes in that they can have one, two, three, or more levels, gourmet kitchens, finished basements, brick walls, and fireplaces. And, no, they don’t have wheels.
- ✔ Prebuilding in a factory saves time because workers aren’t delayed by weather or lack of available materials.
- ✔ The volume of building at the factory means workers can be concentrated in one place — painters can stay busy in a modular home factory shift after shift. They don’t have to travel from job site to job site or wait between jobs.
- ✔ Inspectors in the factory ensure that work is done precisely to plan and with closer tolerances than on a job site.
- ✔ Best of all, you’ll likely save money by choosing a modular or panelized home. Here’s where the savings come in:
  - There is less risk that valuable building materials will be stolen or damaged on the construction site.
  - A shorter construction time means fewer interest payments on your construction loan.
  - Design work or drawings may be included in the price of the home package so you can avoid paying an independent designer or architect.
  - Because you can’t make changes to the structure after it reaches your site, you don’t rack up expensive change-order fees.

Still, a modular or panelized home may not work for you for various reasons. Access to your site might be impossible for large delivery trucks. Your home’s designer, architect, or contractor may prefer to work with conventional site-built methods. The level of amenity you want for your home may just be too high to be efficiently fulfilled by a system manufacturer.



If you’re considering a modular or panelized home:



- ✔ **Start with the companies' floor plans.** Review them and their list of construction specifications.
- ✔ **Make sure your site is accessible to the trucks that will deliver your home's components.** Speak with your representative to make sure your site is appropriate.
- ✔ **Begin looking for a general contractor to oversee the building of your home's foundation, the installation of the prefabricated components, and the final finish work.** If you want to serve as your own general contractor, ask the manufacturers you're considering if they have worked successfully with owner-builders in the past.
- ✔ **Tour as many system-built homes as possible.** You can see firsthand how the finished structures look and feel.
- ✔ **Inspect each company's finished product closely.** Ask questions of people who have lived in the houses for a few years or longer. Have the homes stood the test of time? Are the homeowners experiencing any problems with their homes?
- ✔ **Check out appropriate Web sites.** For fast facts about system-built homes, compiled by the Building Systems Council of the National Association of Homebuilders, go to [www.nahb.org/generic.aspx?sectionID=455&genericContentID=10216](http://www.nahb.org/generic.aspx?sectionID=455&genericContentID=10216).

## *Making a purchase*

If you have your home system-built, you'll first contact either a local builder who has experience putting the houses together or a local system-built home manufacturer representative. The representative or dealer you purchase your package from will have specific assembly and construction instructions for your contractor. Many manufacturers provide training courses for complex systems, and in some cases, the representative also serves as a contractor.

You need to find a company that can provide you with two things: A home design that fits your needs, or that can be altered to fit your needs, and a home built to the level of amenities that you desire.



Not sure what design works best for you? Our advice is to study each manufacturer's stock designs and then ask if the manufacturer has the ability to customize the plans. To determine the quality of a manufacturer's homes, ask to see the company's specifications. Some areas to take note of include

- ✔ **Insulation:** The manufacturer builds your home to meet the insulation level required by your local building codes. If you want greater insulation, talk to your manufacturer, and expect to pay more.
- ✔ **Pitch of the roof:** A flat pitch makes the home look more like a trailer-park model and less like a custom home. Steeper pitches look richer.

- ✓ **Roofing and siding materials:** If a manufacturer can't provide a certain type of shingle or exterior finish for your walls, you can have your builder apply the shingles after the home is on-site.
- ✓ **Stairs:** The standard stairs may be carpet-grade. In other words, you need to cover the stairs with carpet. If you want exposed wood on your stairs, ask what options are available. Again, be prepared to pay for an upgrade.
- ✓ **Types of appliances:** Can the manufacturer accommodate your lifelong desire for a commercial-size range in the kitchen and a high-end, built-in refrigerator? Some can, but be prepared to pay extra.
- ✓ **Windows:** Ask about your options for windows, and be sure to see the window units firsthand. Be sure the windows are easy to open, close, lock, and tilt for cleaning (if that's a feature you prefer). For more in-depth information on comparing window quality and energy-efficiency, visit the EnergyStar program's Web site at [www.energystar.gov/index.cfm?c=windows\\_doors.pr\\_windows](http://www.energystar.gov/index.cfm?c=windows_doors.pr_windows).

If you have firm ideas for your new home, make sure the manufacturer you choose can supply what you need. For example, do you have your heart set on a vaulted master bedroom? Because they are limited by what size components can be delivered by truck, not every modular manufacturer can build a home with ceilings above 8 or 10 feet. Ask questions and be sure to look at homes the company has previously built.

Perhaps you want to bring your own drawings to the table. Some modular manufacturers can accommodate custom-drawn plans, but you may find that panelized manufacturers will more readily accept plans from an architect or independent designer.

## On the line

With modular homes, workers install wiring, plumbing, ductwork, cabinetry, and some plumbing fixtures in the factory, and also apply certain finishes, such as paint, flooring, and countertops. After the workers finish, they shrink-wrap the modules like giant pork-chop packages and load them onto flatbed trucks for delivery.



Before you hit the road, Jack, be sure you know the rules. Some states limit the weight of items that can be shipped by truck at certain times of the year. Imagine that a truck carrying your kitchen jackknifed on an overpass in a blizzard, or worse, overturned. Discuss your construction schedule and any possible restrictions with your contractor or sales representative well in advance of your purchase.

After the house arrives at your lot, workers cut away the heavy-duty wrapping from the modules, and a crane lifts the modules off the trucks and on to the home's foundation. Depending on its size, the home may comprise two, three, or more modules. Under the supervision of your builder or manufacturer's representative, the crew completes the steps necessary to make the home ready for occupancy.



A modular home leaves the factory pretty close to complete. After the pieces arrive on the construction site, the homeowners can usually move in within just a few weeks. Make sure you're packed and ready to move in.

Panelized homes go up in much the same way, except that the parts that are delivered to the site are smaller and require more assembly on-site. A crane may still be needed for lifting large wall or roof sections. After the pieces are in place, the home is ready for interior finish work. The construction time may vary from one system to another. Obviously, those systems that leave the factory in more-finished states require less time and labor on-site.

## *Unearthing Alternative Construction Methods*

Does a system-built home sound too buttoned-up for you? If so, then get earthy with alternative building methods. Some of these methods are ages old and recently rediscovered; others have become viable and more widely available by recent technological improvements. Two different options include

✓ **Straw bale homes:** Today, people are rediscovering the ability of straw bale construction to create highly energy-efficient homes. After the bales are stacked into walls, they are coated outside with an earth-based material and inside with plaster, and then finished as any other home.

Straw bale homes usually resemble adobe homes with thick walls and gently rounded arches. They offer their owners great efficiency and a quiet interior. An added bonus is knowing that you created something lasting out of a material that would normally be burned or sent to the landfill.

In laboratory tests, the bales have resisted damage from fire, mainly because of their density. Insects don't seem to be a problem and moisture issues aren't of great concern as long as the bales are well dried before construction and kept dry until they are finished on the exterior. Check with your local municipality and lenders if a straw bale home sounds like your cup of tea.



- ✓ **Rammed earth homes:** Like straw bale homes, *rammed* (or stabilized) earth homes use a natural material to create a cozy home with thick walls. In this type of construction, your wall contractor mixes *screened* (sifted) soil with cement and water, and then pours it into wall forms built on your site. The crew then uses pneumatic tampers to compress the earth mixture in the form. After the mixture sets, the forms are removed and the 18- to 24-inch walls are complete. The walls can be left as is, colored with pigments, or sealed with stucco.

As with other building forms that create thick, solid walls, rammed earth homes enjoy increased energy efficiency and quiet interiors. Solid, natural material walls paired with a heating system that doesn't require blowing air provides an ideal home for those with heightened sensitivity to chemicals or synthetics.

Keep in mind that although the raw materials for a rammed earth home — notably dirt — are widely available and, well, dirt cheap, the labor involved adds to the home's cost. Knowledge is the best weapon when encountering setbacks, so visit rammed earth suppliers online or in person and talk about your plans with homeowners and builders who have relevant experience.

If you're interested in an alternative building method or material for your custom home

- ✓ **Do as much research as possible.** Look for magazines like *Natural Home* and books such as *The Art of Natural Building* by Joseph F. Kennedy, Michael Smith, and Catherine Wanek (New Society), and *Alternative Construction: Contemporary Natural Building Methods* by Lynne Elizabeth and Cassandra Adams (Wiley).
- ✓ **Get help.** Enlist the aid of experienced builders or suppliers.
- ✓ **Attend workshops and seminars.** Many producers or building schools offer workshops and seminars, which are particularly valuable if your home will be a do-it-yourself project. Knowing in advance if you have the skills and persistence to tackle the job is better than finding out too late.
- ✓ **Look online.** Check out [www.greenbuilder.com](http://www.greenbuilder.com), [www.thelaststraw.org](http://www.thelaststraw.org), or <http://oikos.com/index.lasso> for further information on an array of alternative building methods.

Believe it or not, you *can* find financing for a home built with alternative building materials. It may, however, take more legwork than finding a lender to finance your purchase of a regular suburban tract home. Start by talking with the company that's helping you build the home. Most likely, the company's previous clients have faced the same situation, and they may be able to offer sound advice. You can also search online for lenders who frequently make construction loans. Having complete plans for your home, information on the building system from an experienced builder or home producer, and a clear idea of the costs of your project can help ease a lender's mind and make your project that much more appealing to a loan underwriter.

## Living off the grid

For some, the idea of living without public utilities or supplementing those utilities with wind, water, or solar power sounds like roughing it. But technological advances in these alternative power systems make it easier for people who wouldn't consider themselves pioneers to make their own energy.

The use of alternative energy sources probably won't affect your home's style except in the instance of passive solar heating. Homes designed to benefit from solar energy in this way are carefully sited on their lots. Banks of windows bring sunlight into the home and focus the warmth into the home's *heat sink* — typically a masonry wall or floor that collects the warmth, and then slowly radiates that warmth back into the home. Of course, if you use active solar systems, such as panels of solar cells for generating electricity or large solar collectors for heating water, you'll need to either hide them or integrate the look into your home design.

If you're interested in using alternative energy to power your home, research your choices thoroughly. Start with books and magazines, and then supplement your reading with visits to the Web sites of suppliers of solar, wind, and water energy equipment.

Although building a home powered solely by alternative energy (called *off-grid*) is good for the planet, it may cripple your checkbook: Homes that are built off-grid aren't eligible for bank financing. If you need a loan, connect your home to the grid, and then simply use your alternative energy system. Many people who make their own power, but who are still connected to the public utility grid, are actually able to "sell" their excess power back to the utility company. Rules and regulations on this buy-back of power vary from region to region. For more information, visit [www.oikos.com](http://www.oikos.com).



## Chapter 5

# Architects and Design: Time Spent Is Money Saved

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### *In This Chapter*

- ▶ Using an architect
  - ▶ Relying on other design resources
  - ▶ Placing the house
  - ▶ Making aesthetic choices
  - ▶ Defining the details
- 

**D**esigning your own home is probably the reason you started on this custom home journey in the first place. But, guess what? Designing your own home also is the most complicated and challenging part of the process (although at the same time it can be the most rewarding). Wondering what the biggest mistake made in the design process is? Underestimating the time you need and the sheer amount of decisions you need to make.

In this chapter, we assist you with the multitude of decisions and choices that you'll face by giving our insights from our own years of experience. We start with the discussion of using an architect, relying on a stock plan, or designing your new home yourself. We give you an introduction to choosing styles and determining functionality. Finally, this chapter has lists of features and choices to use when making the necessary decisions for your custom home. The result is a script for you to follow in conversations with your architect and contractor.



You're designing *your* custom home project. There is no right or wrong way. But some ways may be easier or less costly than others. Entering into the design process with open ears and an open mind is better than resisting new ideas. Be prepared to take extensive notes during the process because it occurs over an extended period of time, and you may need to refer back to what you were talking about six months ago.

## *Arming Yourself with an Architect*

Like any other professional consultant, because you're paying the money, you have the right to determine how much your architect will be involved in your home-building project. Architects can serve you in several ways. They can take a stock plan you have seen in a magazine or on the Internet and simply modify it to fit your needs, or they can help extract ideas from your mind and create a whole new home to meet your dreams. Some people simply want an architect to design a home based upon their thoughts and needs. Others want to be fully engaged in the entire experience and use the architect as an interpretive tool, expressing what they see completed in their own mind.

### *Deciding whether you even need an architect*

The question of whether or not you need an architect for your project boils down to two elements: time and experience. If you're in no hurry to move your project forward and are willing to invest the time to figure out all the ins and outs of the process and make the right choices, then an architect may be unnecessary. But if you work for a living, are raising a family, or don't have the slightest inclination to take the time to figure out design, construction, and building codes, then an architect will be a welcome addition to your custom home team of professionals. Here is a list of questions you need to ask yourself to determine if you're up to the task of designing your own home:

- ✓ Does your state require an architect for submitted plans?
- ✓ Will your project require extensive structural engineering?
- ✓ Are you extremely picky and difficult when making decisions?
- ✓ Are you lacking in aesthetic vision?
- ✓ Do you have difficulty understanding home functionality?

If you answer yes to any of these questions, then you'll probably gain value from an architect. Despite their seemingly high cost, architects can save you time and money by bringing their experience to the table. Their insights on functionality and government bureaucracy can save you months of time and thousands of dollars.



The biggest question to ask yourself is whether you have the confidence to take this project to its completion. You may prefer to dabble or play with the design aspects, but an architect is a true professional who has spent years becoming an expert at home design. If you were to go alone without



an architect, you might spend a great deal of time and energy gathering the information that already sits at the architect's fingertips.

## *Finding the right architect*

Locating an architect is as easy as picking up the phone book or searching on the Internet. The hard part is figuring out which architect is right for you. You have several approaches you can take to find the right architect:

- ✔ **You can drive through neighborhoods of custom homes looking for houses that strike your fancy.** Don't be afraid to knock on the door and ask for the architect's phone number. Most people are happy to share the information while you're flattering their home.
- ✔ **If you're lucky enough to have many friends with custom homes, you can ask for referrals from them.** What are friends for?
- ✔ **You can hit the Web.** The American Institute of Architects (AIA) has a list of its members by location at [www.aia.org](http://www.aia.org). Click on the "Architect Finder" option, enter your zip code, and select the "A Home for Yourself" building type to find architects in your area.

Now that you have a list of prospects, you need to compare them. Cost is usually the first comparison but by no means the most important. When choosing the right architect, look for someone that fits the needs of your particular project and working style. You may want someone who manages the whole process or perhaps will work with you in a teamlike manner. Plan to have several discussions with two or three different architects so you can choose the right one for you. Here are the important issues to address in those discussions:

- ✔ **Aesthetics:** You need to see if the architect can create something that suits your taste. Ask to see many of her prior designs. Ask for introductions to the owners. Go to the completed houses and see if the floor plans make sense and are comfortable for you. If you don't like the homes she previously designed, chances are you won't like a new one either. A good architect is also a good listener. Look for someone whose taste is similar to yours and who will design what you're looking for. You want your new home to be a reflection of you — not a monument to the architect.
- ✔ **Experience:** What's the point in hiring an expert who knows less than you do? You want an architect that has designed many custom homes and is familiar with the process. A commercial architect who specializes in office buildings may be looking for the next new challenge, but his lack of residential experience could create problems for you down the line with builders and planning departments. An architect needs to have a minimum of 15 custom homes under her belt to be considered for your project.

✓ **Local knowledge:** Every municipality and planning department is different in the way they process custom home plans. Some are more bureaucratic than others. Much of the architect's time may be spent working your plans through the system. If you're looking for exceptions (*variances*) from the established local guidelines, you could have a fight on your hands. This fight could cost you time and money. An architect with local knowledge and experience can save you from costly battles and exercises in futility. (Check out Chapter 6 for more information on local design guidelines.)

## *Managing the architecture process*

If you're lucky, you may find the perfect architect — someone who is attentive to your needs and makes the process easy. In a perfect world, the architect would come up with the perfect design first time out with a minimum of communication. Sadly, wake up and smell the coffee: You don't live in a perfect world. Most custom home architects are small businesses; they're shoe-string operations without huge profit margins. They tend to be overloaded with work and less concerned for your time frames than you may be. The more successful the architectural firm, the busier it will be. You need to manage your expectations and the process.



Set your initial meeting as a getting-to-know-you session to get a feeling for how you'll work together and to see if you have a common vision for the project. After everything gets going, stay proactive in driving the process. (To stay on top of everything, you need to call the architect regularly to check progress and set the next appointment.) After all, it is your house and your time frame. The architect's job is to present you with information and decisions to be made. All the decisions relate to four basic elements:

- ✓ Aesthetics
- ✓ Cost
- ✓ Quality
- ✓ Time



Get the facts from the architect and conduct your own research. The more you take responsibility for educating yourself and making some decisions upfront, the greater chance you have of eliminating problems, saving some money, and getting the home you're looking for. Use your architect as the high-paid consultant that he is and make sure to set a regular meeting schedule with him. Doing so helps you get a better handle on the time and dollars involved to design the project. Setting a regular schedule also reduces the panic or inquiry calls that can cost you more money and frustrate you during the process.

## *What does all this cost?*

The architect has the worst position of all the partners you have in the custom home process — the first position. Most people expect to put out a substantial chunk of money for the building lot, but the five-figure check you'll write to the architect is probably the first one you signed that didn't get you a big hunk of steel with tires and headlights. Don't let the price tag scare you; during this stage isn't the time to skimp. If you've done a good job of budgeting (see Chapter 2), you'll easily make up the initial costs later in the build.

Architects generally charge in one of three ways (or a combination of all three for various stages of the project):

- ✓ On an overall percentage of the build
- ✓ On an hourly basis
- ✓ On a fixed-price basis

The following sections provide some vital information you need to know about each billing program and which one is better for you.

### *Percentage of the build*

The first way of billing is on an overall percentage of the build. This method can range anywhere from 3 to 10 percent of the total project costs, not including land. So a typical \$500,000 custom project may cost you \$15,000 to \$50,000 in architect fees for the plans and the architect's time in getting the plans approved. In some high-end projects, architects may charge as much as 20 percent, equaling hundreds of thousands of dollars. This method doesn't have a set percentage, so you need to evaluate the value of the architect's services that you receive in exchange for your hard-earned money.

### *Hourly basis*

The second way of billing is on an hourly basis. Hourly rates vary widely depending on the firm you engage, its experience and reputation, and its location. (A firm in Los Angeles is probably going to cost significantly more than one in Des Moines.) Expect to pay anywhere from \$50 to \$350 per hour, depending on these factors. You'll pay the architect for the following list of items to get you to the permitting stage:

- ✓ Construction documents
- ✓ Landscape plan
- ✓ Mechanical and electrical drawings (see Chapter 6)
- ✓ Plan copies (\$4 per page)

- ✓ Soils report
- ✓ Structural engineering (see Chapter 6)
- ✓ Surveyor
- ✓ Time for the architect and associates

You can pay all these items directly through the architect, or you can pay for them separately on your own. Project costs can be more clearly broken down into time and materials (expenses), and they'll vary depending on where you live and on your project's scope. The consultants and types of reports they can generate vary due to the scope of work and the requirements of governing bodies, such as planning and building departments.



When paying by the hour, time is money. Use the architect's time for providing information and education. Keep all discussions or disagreements between spouses or partners at home, not in the architect's office while the clock is ticking. Absorb as much information as possible and take detailed notes to review on your own time. The more you prepare for the meetings with the architect, the more efficient those meetings will be. Shorter meetings mean less billable hours and less money out of your pocket.



## Considering the design-build combo

A number of companies today design the homes and build them for you. Such companies are called design-build firms in the industry. Many custom home companies have added architects to their staffs so they can provide you with a seamless process from start to finish. The main advantage of this approach is consistent communication throughout the process. The builder has experience building what the architect designs and the architect designs a home based on the builder's expertise. You can take advantage of the cost savings attached to using one firm for both the design and the build, but you need to compare the price and work with that of independent architects and contractors before making a decision. You can find an annual list of leading design-build firms online at [www.designbuildbusiness.com](http://www.designbuildbusiness.com).

Just because they handle both design and build aspects through one firm doesn't mean you can reduce your investigation for finding the right partners for your project. Design-build can be something of a conflict of interest because it doesn't involve any competitive bidding in the process. Not only that, but the project's ultimate quality is tied up in the firm's ability to both design and build in a cost-effective standard. Pick a design-build firm using the same criteria we suggest for picking an architect in "Finding the right architect" section earlier in this chapter, and investigate the builder portion of the firm using our suggestions in Chapter 2.

### *Fixed-price basis*

The third way of billing is on a fixed-price basis, where your architect quotes you a firm, all-inclusive price for the entire job. On one hand, this option can be beneficial to you because you know exactly what your architect will cost, but an architect may underestimate and you may suffer when he feels he has already put in too much time.



Always discuss the price with the architect before you sign a contract. Get a complete estimate upfront with a detailed breakdown of expenses. Set a maximum price with progress payments based upon certain milestones such as the preliminary design and design review approval (discussed in Chapter 6). Keep the communication open along the way so you don't encounter any surprises.

## *Looking at Architect Alternatives*

Not everyone uses an architect when building a custom home for several reasons. For example, aside from money being a factor, you may have design skills yourself that you wish to exercise. No problem! Technology has improved the choices for designing a custom home. You can also utilize alternative consultants if you want to save on architecture fees. These resources require additional responsibility on your part and may still have additional costs depending upon the design requirements of your local government. The following sections explore architect alternatives.

### *Published floor plans — Picking a home from books or online*

You can purchase thousands of plans from magazines and online resources — many of them quite good. The choice is endless. The magazine shelves at bookstores are stocked with more than ten new magazines every month; these plan books have houses to fit every size and budget. You can buy the preliminary floor plan and elevations for a few hundred dollars. You can also purchase complete building plans including the structural drawings from these sources for a few hundred to a few thousand dollars. (Check out Chapter 6 for a complete explanation of the differences in types of plans.) Even if you don't buy the full set of plans, the magazines and online sites make for good conversation starters with your family and architect. Here are a few of our favorite Internet resources for plans:

- ✓ [www.familyhomeplans.com](http://www.familyhomeplans.com)
- ✓ [www.eplans.com](http://www.eplans.com)
- ✓ [www.dreamhomesource.com](http://www.dreamhomesource.com)



Although buying plans may seem like a less expensive approach than using an architect, it depends heavily on your situation. Many of these plans don't include the foundation or full structural drawings required for permitting. The plans need to meet all the design and code regulations for your area, and if they don't, you'll have to hire an architect or engineer to make any changes necessary for permitting. Depending on those costs, you may or may not save money by using the stock set of plans compared to hiring an architect to design your home. Buying plans from a book can, however, be a great option if you're building on a flat lot with liberal design guidelines. Otherwise you may be wasting your money.

## *Software programs — Designing your own plans*

A number of software programs exist for individuals wishing to design their own home on a computer. Many of these software tools make it easy with templates for rooms and architecture choices. For less than a few hundred dollars, these programs can be excellent tools for discovering the basics of home design — saving you time and money with your architect even if you don't design the entire home. If you find yourself with the time and skill to design the whole project, you can save significant money. Here are our favorite software choices available online or at any computer store:

- ✓ [www.smartdraw.com](http://www.smartdraw.com)
- ✓ Better Homes and Gardens Designer Suite
- ✓ 3D Home Architect



The same issues apply when designing your home using software as with store-bought plans — the need for foundational engineering and structural drawings. However, in this case you're now responsible for all the structural elements of the house construction. Make sure to find a structural engineer you can work with before heading down this path. You'll need to search the phone book or ask architects or local building departments for referrals to find a good structural engineer. Otherwise your new home may become your design nightmare.

## *Hiring a home designer*

You can also choose from a growing number of talented home designers who aren't licensed architects. They offer you the possibility of significant cost savings in the design phase of building your new home. They don't have the architectural training or certification, so they bill at a lower rate than architects. These designers may draft the house design for you from scratch or

help you determine materials. No standard for the services they provide exists, so you need to ask them what part of the process they will provide. Treat them as you would any architect. Investigate their credentials and experience. Discuss with them the differences in the services they will provide from architects and other designers and find out where the gaps exist. The best way to find these designers is in local newspapers and design magazines.



Many states limit designers from designing anything more than a bathroom, kitchen, or single-story remodel without the plans being approved by an engineer with an engineer's stamp before obtaining permits. In addition, a designer may not be aware of code complications in a more extensive project, creating more cost to fix the plans even with the engineer's assistance.

## *Placing the House on the Lot*

Before you start designing your new home, you need to figure out how it will sit on the lot. Lot placement is important because it allows you to take advantage of views, topography, and amenities. Some lots may have special features or limitations that make this decision a simple one. Others that are large and flat may have limitless possibilities. We lay out some of the biggest considerations in this section.

### *Foundation issues*

If your house is on a slope, then the engineers are going to give you limited choices in how to place the house on the lot. You'll have to follow very specific requirements for grading, piers, or other specialized foundations. If your topography is far from flat, you may want to consult an engineer early in the design process. You can do this through an architect or consult the phone book.



Constructing a foundation can be complex, and you need to discuss it with the architect or engineer during the house design process. To understand the specific process for hillside foundations, look in Chapter 12.

### *Which orientation is best? North, south, east, or west*

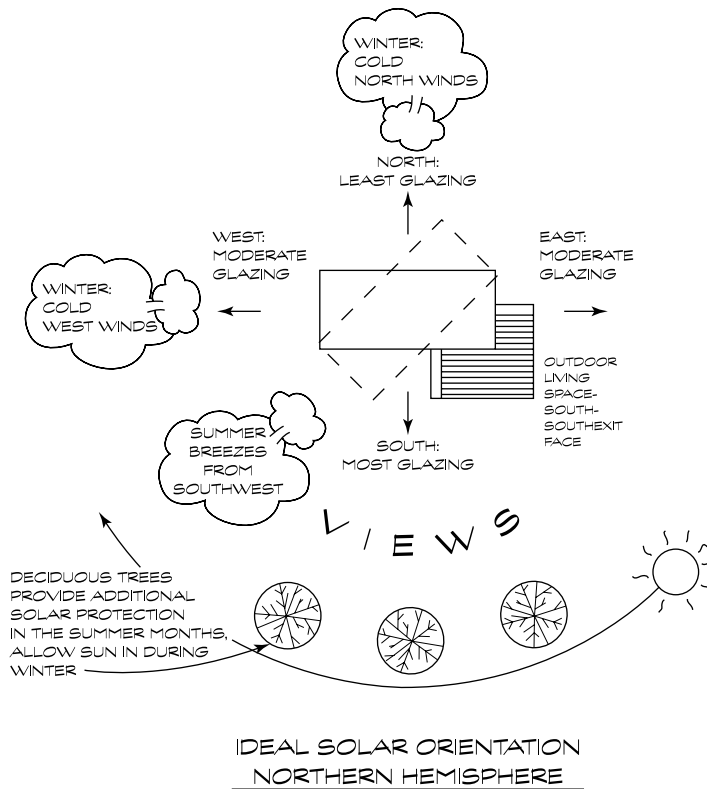
There are no right or wrong answers for picking direction placement for your home — it's a matter of preference. Some people like the sun in the morning and some in the afternoon. If you're building in Seattle or Vancouver, the sun may not be a factor at all.



In North America, the sun shines from the south so a southern exposure means that the sun will shine on the front of your home for most of the day. A south-facing house also means your backyard may get little sun until midday, when the sun is high enough in the sky to shine over your house. Figure 5-1 shows the relative angles for exposure and house placement.

Too little sun can make the house seem dark and dank. Too much sun can be energy inefficient and weather the house prematurely. You need to consider other directional factors, such as wind, noise, and city lights, that can negatively impact your home. To decide on the right direction, ask yourself the following questions:

- ✓ What are sun patterns where I live?
- ✓ What is my preferred daily temperature?
- ✓ How bright do I want my home?
- ✓ How much sun do I need in each yard?



**Figure 5-1:**  
Exposure  
impacts  
placement.



- ✓ Where does the wind normally come from?
- ✓ Where is the closest major city?
- ✓ Are there any noise issues in any of the directions?

After you have considered these questions, determining which direction will benefit your lifestyle and then designing doors, windows, and decks to face that optimum direction should be easier.

## *Taking advantage of natural elements*

In some suburban neighborhoods, the most natural thing about your lot may be the hippie couple living next door. However many people building custom homes have some natural features that can add to their home's beauty. Following are some natural elements to consider in the design and placement of the home:

- ✓ **Foliage:** If your lot is in a rural area with plenty of natural landscaping, consider natural growth patterns for beauty and easy maintenance. High trees and bushes can afford you privacy; however, clearing tall brush and cutting back trees may give you unexpected views.
- ✓ **Mountains:** If you have a larger lot in a mountainous area, decide to be on top of the peak or shaded at the foothill. Or you may simply prefer to stare at the neighboring giant.
- ✓ **Rocks:** Small groups of stones or even large boulders can make for a dramatic effect depending on where you place your house. In some rural and mountainous areas, designers have built spectacular homes with boulders *in* the house making the home unique and saving the cost of demolition.
- ✓ **Trees:** Trees provide shade and beauty. They can also be a nuisance with dropping leaves and fruit. Like boulders, some old magnificent trees can be incorporated into the home's design.
- ✓ **View:** The right view can significantly increase your home's value and beauty. Try to optimize views for rooms where romance, relaxation, and entertainment occur.
- ✓ **Water:** People pay premiums to live by the ocean or near lakes and rivers. Take advantage of these aquascapes, but be wary of flooding issues by checking flood maps with your engineer.



Custom home projects tend to run smoother and cheaper when they're designed to take advantage of natural elements. Reconstructing landscape and waterways or removing huge trees and boulders can be costly and in some cases environmentally damaging. Look for ways to take advantage of what was naturally provided.

## Nothing is as lovely as a tree

One very expensive cost for a new home can be trees. In new developments, the land is bare and the cost of transplanting a mature tree can be as much as \$20,000. The expense of mature trees is the reason why it takes decades for neighborhoods to have tall trees. If you're lucky enough to have mature trees on your property,

take advantage of them in your house placement. In some locations certain trees may be protected, such as live oaks in California (the state tree). You can get plenty of information about types of trees and how to protect them from the National Arbor Day Foundation ([www.arborday.org](http://www.arborday.org)).



When making significant changes to the elements, work with your engineer to create proper site drainage and insure the soil will remain stable with few erosion problems. Otherwise your house could slide down the hill or be buried by mudslides.

## Planning the Size and Shape of Your Home

Even though building a custom home implies you do it your way, few people actually have enough money to put everything they want into their first project. Unless you recently won the lottery or invented the cure for the common cold (congratulations if you fall within either of those two categories!), you'll probably have some limitations on what you can build. Also, unless you're in a position where money has no bearing, you'll want the house to maintain its value and potentially appreciate.

So you now have three gods to appease:

- ✓ **Desire:** You want to build a house you want for your needs.
- ✓ **Taste:** You want the house to have aesthetic appeal, particularly to you.
- ✓ **Value:** You want to make sure the house is built in such a way to maintain its investment potential.

You must carefully consider all three of them in the design process.

## Size matters — Figuring the right square footage

For reference, you'll often see square feet represented by a number with a symbol so that it looks like this: 2,000<sup>sq</sup>ft. Three major factors dictate the appropriate square footage for your home:

- ✔ **You need to establish your family's needs.** For example, do you have elderly parents living with you who need a downstairs bedroom or does your wife want her own separate walk-in closet in the master bedroom? We address this topic more in-depth later in this chapter in “Ten general floor-plan considerations.”
- ✔ **You need to adhere to zoning limitations or covenants (neighborhood guidelines).** Many design rules set limits on how big and how small of a house can be built on a particular lot. You may also encounter limits on the house's ground floor. These guidelines may impact other decisions such as the need for more than one story to meet your square footage needs. (See Chapter 3 for more on zoning regulations and covenants.)
- ✔ **Your need to keep in line with your budget.** In Chapter 2, we give you a method for determining a budget as well as a way to define *dollars per square foot*. You'll need to design a house that not only fits your family and the lot but also fits your budget as well. Many of these calculations go in circles, so start with the house you want and see if it fits based upon local estimates for building costs, which you can get by talking to a few contractors. If the going rate seems to be \$100 per foot and your budget allows for \$300,000, then a 3,500 square foot house won't work and you need to adjust your design.



The more square footage you build, the more the house will cost, so efficiency is important. At the same time, skimping on rooms can reduce utility and make for unpleasant living. Here are some minimum recommendations for typical room sizes to give you a general idea of what you need:

- ✔ Bedroom: 100 to 200 square feet
- ✔ Dining room: 100 to 300 square feet
- ✔ Family room: 300 to 800 square feet
- ✔ Full bathroom: 60 to 150 square feet
- ✔ Great room: 400 to 1,000 square feet
- ✔ Kitchen: 150 to 350 square feet
- ✔ Living room: 300 to 800 square feet
- ✔ Master bedroom: 200 to 600 square feet
- ✔ Staircases: 100 square feet per story

Calculate the total square feet of the rooms you have picked. You can figure on adding another 10 percent to account for hallways, cabinets, and closets. This total can give you a basis from which to start your estimate. Other factors to consider may include unfinished space like basements and garages. Garages can vary based upon size, but each car needs roughly 200 square feet. Generally, a basement matches the square footage of the first floor. If you're not going to finish the walls and flooring in your basement or garage, then you don't count it in your livable square footage, but you'll need to reconcile the cost when you get your estimates from contractors. You can estimate its cost now by multiplying the square footage by the dollars per square foot and dividing by 2.

## *Designing for resale — Create a house everyone wants to buy*



When designing your home, you want to remember that a unique house can create difficulty even in a custom home — particularly thinking ahead to the future and your new home's resale value. For whatever reason, most people prefer houses that are familiar, functional, and comfortable, which means many people may find your home to be a nice place to visit but they wouldn't want to live there. If buyers aren't interested in your house, lenders will shy away as well making financing difficult. (We discuss the issues of marketability in greater detail in Chapter 7 and the lender's perspective in Chapter 9.)

Just because you want to design your house with resale in mind doesn't mean the house has to be generic. A number of proven theories in home design create functionality and appeal yet allow for uniqueness. Talk to local real estate agents and your architect about the expectations of most buyers in your neighborhood. You don't have to build your new home exactly for them, but at least you can consider them in your design decisions as you move through the process.

## *Exterior styles — Considering architecture examples*

Some local guidelines require specific architecture styles for the neighborhood. Some design review committees may actually dictate the type of siding to be used and colors to be painted. We discuss these committees at length in Chapter 6. The key is to pick something that suits the neighborhood and your taste. You can choose from many examples of exteriors in plan books and on the Internet.



Knowing the size of the home isn't enough to get a handle on costs. Not all exterior designs cost the same. The more complex your exterior is, the more it will cost in framing (see Chapter 13). Architectural extras such as peaked roofs, dormers, and balconies can increase costs. Exterior materials have an impact on cost as well. If the neighborhood guidelines allow it, you'll have to choose between siding, stone, or stucco as well as roof material choices like slate, tile, or metal. We discuss these material choices extensively in Chapter 14. Do your research on these materials now by checking prices and discussing options with your architect.

## Designing Your Home's Interior

Although design review committees may have a lot to say regarding your home's exterior, the interior choices totally belong to you. The floor plan determines where everything is located in your house. A well thought-out floor plan can make for a comfortable house whereas a bad floor plan can create problems and inconvenience.

Several components, such as doorframes and hallway passages, require you to make decisions about style, size, and location. For example, choosing an open feel in a house requires open passages and larger hallways whereas privacy needs may push you to opt for smaller cozier options. These decisions impact the feel of the house and, ultimately, your enjoyment of it.

Other interior choices on details such as corners and finish trim can add significant themes to the look and feel of your home's interior. You can find hundreds of interior ideas in the multitude of home magazines on the rack at the bookstore. *Interior Design* magazine is excellent for ideas and, of course, you can always find plenty of pictures in the classic *Architectural Digest* and on the Internet.



The best way we have found to search for ideas on the Web is to go to [www.google.com](http://www.google.com), click on the "Images" button, and search terms such as *interior architecture* and *interior design*. You'll get hundreds of pictures to look at for ideas.

### Ten general floor-plan considerations

Whether you're designing the house or using an architect, you need to be aware of elements of good home design. We lay out these elements in this section so you can incorporate them into your thought process while designing your home. Our experience shows that most design problems in the flow

and functionality of the house result from not addressing one of the following areas:

- ✔ **Lifestyle:** To be comfortable and relaxed, your home has to fit your lifestyle. Not every home works for every family. Are you a family living in a formal style? If so, then maybe you need a formal living room and dining room. Do you gather around the kitchen? Do you entertain a lot? Then a home with a big family room open to the kitchen may work for you. Determine how you want to live and design a plan that fits the lifestyle you enjoy.
- ✔ **Foot traffic:** Try to project how people move through the house on a daily basis. Look for problems in the traffic patterns. Some problems may include issues like tight hallways and people crossing through work areas of the kitchen, formal areas, or TV-viewing areas. (You don't really want Little Johnny racing through your dinner party in his Spiderman tighty-whities to get to the bathroom.)
- ✔ **Noise:** This factor can be huge in multilevel houses. Remember that bedrooms are for sleeping, so any noise above, below, or next to a bedroom can make for a restless night. Consider carefully the placement of noise-generating rooms like the garage, home office, laundry room, and bathrooms. (For example, if you have a large family, you don't want to put the main bathroom by your bedroom. The last thing you want to hear is a flushing toilet all night.)
- ✔ **Storage:** You can never have enough storage space in any house. The longer you live somewhere, the more stuff you acquire. What you really need is plenty of useful places to put it. Create ample-size closets, pantries, and cabinet areas. And make sure your storage areas are convenient without being obtrusive.
- ✔ **Door placement:** Every room needs a door, but it needs to open in such a way that it doesn't bang against walls, obstruct other doorways, or block closets or windows. Consider the placement and opening space necessary for each door in the house.
- ✔ **Window placement:** What's the point of having a view if your windows don't take advantage of it? Other window considerations include privacy, not being blocked by doors, or looking out on the garbage area. Put plenty of thought into the size and placement of your windows to the world.
- ✔ **Accessibility:** Can you get to the outside from everywhere that makes sense? Are bedrooms and bathrooms easy to access from common areas? Make sure you can easily access important rooms without creating unnecessary obstacles.
- ✔ **Convenience:** We can think of nothing worse than having to traipse halfway across the house with food from the kitchen to serve in the formal dining room. Think about where you may be unloading your groceries or how to get the food from your barbecue. Bathroom placement is another major convenience consideration.

- ✔ **Utility:** Many homes have nooks and cubbies that serve no useful purpose. You'll pay to build any square footage whether or not it's useable space. Make sure all areas serve a purpose.
- ✔ **Future expansion:** Perhaps your new house is perfect for all your needs at this time, but someday your needs may change. Think about how you might expand the house should that occur.

## *Special considerations room by room*

We realize many of you are hoping in this section for a detailed list of decisions on design in the various rooms of the house. But if we made all the design choices for you, then your new home wouldn't be custom.

In this process of custom building your home, all the decisions are yours – you're in charge. Our job is to share our insights on the questions. In this section we give you questions and suggestions to analyze when designing the rooms. You can use it like a checklist. Then you'll have a good basis for conversation with your architect or designer. For those of you designing your own house, use this section as a template for decision making.

### *A cook's tour — Kitchen elements*

Isn't it funny how every party eventually ends up in the kitchen — often one of the smallest rooms in the house? Think about how much time you spend in the kitchen. Food is a critical part of family culture, and you want your kitchen to reflect it. Think about placement for breakfast eating areas. Where are people going to collect and connect? Although the kitchen is usually the most expensive room in the house, the kitchen also brings the best return on money spent in any home. For greater detail on kitchens, you can read *Kitchen Remodeling For Dummies* by Donald R. Prestly (Wiley). Here are our tips for assessing your basic kitchen needs.

#### *Cabinets and counters*

Your cabinetry sets your kitchen's tone as well as establishes its convenience. You have three major issues to consider with cabinetry and counters:

- ✔ **Layout:** You need to make kitchen layout choices in the floor plan including the specific layout of the counters and island. Put your time into the kitchen design early because making cabinetry and counter changes can be costly after materials have been ordered. Walk through as many kitchens as you can at open houses to see what works well for your lifestyle. The general rule is that you don't want to have to walk food over great distances during preparation. You also want to make sure you have adequate room for those appliances you've been lusting after as well as ventilation for your cooking needs.



- ✓ **Cosmetics:** The kitchen design is likely to stay the same for a long time. You can always change the look of other rooms by painting the walls, but you're less likely to change the kitchen cabinets in the near future for simple aesthetics. Cabinetry is expensive. Make sure you have chosen a style and color that will suit the house's style for decades to come. If you get bored easily, consider paint-grade cabinets so you can change the look just like walls.

When making a decision about countertops, you have many choices to consider, but it often comes down to a choice of beauty versus practicality. Tile can be cost effective and attractive, but grout can be difficult to clean. Granite or marble is gorgeous, but expensive and harder to maintain. You can choose from many suitable manmade alternatives such as Corian that will last almost as long as tile or stone. You can even choose from other surfaces, such as laminate, wood, zinc, copper, stainless steel, and even concrete, that have been used for utility and a unique look. Do your homework to determine which surface is best for you and your cooking style.

- ✓ **Size:** The size of your counters and cabinetry and how much storage space you'll need depends upon your cooking style and equipment. Many people like to display their pots in pot racks and others prefer a kitchen that hides everything cuisine related.



The choice of shelving and inserts requires much thought about your lifestyle and needs in the kitchen. Think about the way you like to cook in the kitchen. Make an inventory of all your cooking tools and machines. Then plan in advance and make a map of where they might live. If you're a kitchen gadget-hound that needs everything at your fingertips, then you'll want plenty of counter space and electrical sockets for your juicer, meat slicer, and George Foreman grill.

## Feng shui — The art of balance

Feng shui has had a huge impact on design, especially when it comes to housing. Feng shui is an ancient Chinese system of philosophy, science, and art. Its purpose is to connect people with heaven and earth. It's based upon the interaction of the environment with energy and intention. The feng shui philosophy seeks to obtain a balance between opposites in the environment. So, for example, feng shui philosophies can determine room placement, window and door location, and so on. If you make a feng

shui mistake, to maintain good feng shui, you may need to create fixes such as hanging coins or mirrors to remove imbalance.

Many people find feng shui suitable for creating their own interior design guidelines and even necessary for resale if building in a city with a large Asian American population. You can find out more about feng shui in *Feng Shui For Dummies* written by David Daniel Kennedy (Wiley).



## Custom or prefab?

A big debate rages on about custom cabinetry versus units that are made in factories. The prefabricated companies claim quality control is far better and you can't beat the price. Today's technology allows for tremendous customization of prefab components suiting most situations adequately. However if you're looking to create something worthy of the museum of

modern art, then you need a custom cabinet maker. Custom cabinetry can cost more than three times the amount of prefab, but they make better use of your kitchen space because they're designed to fit exactly. The good news? These artisans can create incredible pieces of curvy-grainy-spectacular-laminated art that will be the envy of kitchen guests for decades.

### *Appliances*

You can probably expect your oven, stove, refrigerator, and dishwasher to last a minimum of ten years. More and more people are choosing cosmetically matching suites of appliances that are matched and installed. Home shows are the best place to find the appliances that will suit your budget and your cooking needs. Pick the largest and best you can afford. You can get great information and compare appliances at [www.consumerreports.org](http://www.consumerreports.org).



Beware of deciding on industrial equipment. Some stoves designed for restaurant use have different power requirements and safety standards than consumer-designed equipment. Many companies, such as Viking, Wolf, and GE, make commercial-grade equipment designed for consumers.

### *Flooring*

Aside from its appearance, the main consideration when selecting kitchen flooring is to remember that it gets the most traffic and requires the most cleaning. Carpet collects dirt and crumbs and so does tile grout. Smooth tile can be pretty, but every dish you ever drop will smash to smithereens. Gaining popularity are waterproof-composite floors such as Pergo or WilsonArt. These floors come in a variety of textures and styles impressively looking like slate or wood, making for a well-designed alternative to linoleum or vinyl. Many architects believe that the best surfaces for kitchens are wood or stone.

### *Bathroom considerations*

After the kitchen, bathrooms are the next most expensive rooms in the house. The labor necessary for all that electrical, plumbing, and tile work adds up quickly. Plus you only have to create one kitchen, whereas you may have multiple bathrooms. Each one can rival the Taj Mahal if you want. You can find specific details on designing good bathrooms in *Bathroom Remodeling For*

*Dummies* by Gene Hamilton and Katie Hamilton (Wiley). Here are the major considerations for the bathroom:

- ✓ **Size:** A full bath has a sink, a toilet, and a bathtub/shower. For a three-quarters bath, take out the tub; a room with only a sink and toilet is a half bath or powder room. Decide what is necessary for each designated area. Master suites and guest live-in areas generally require more space with full amenities.
- ✓ **Surface:** Tile has the cost attractiveness as well as decorative versatility, but grout can be difficult to keep clean. If using pedestal sinks, you can save on counter work. Complete prefabricated cabinet and counter units are also available for less formal cost-effective bathrooms.
- ✓ **Ventilation:** Most exhaust fans are installed for code but serve little purpose. Decide on your most desired form of ventilation. An open window still serves as the most popular and efficient. Be alert to sightlines for privacy from neighbors.
- ✓ **Luxury:** Big sweeping claw-foot tubs, Jacuzzi tubs, built-in saunas, steam showers, and the like are available to make your master bathroom your slice of heaven. Many of these amenities need to be installed early in the process and require high maintenance, which can be annoying and costly. Make these choices early and research to see which pieces appear relaxing but are really more trouble than they're worth.

### *Bedrooms and home offices*

Most people don't designate between guestrooms, den, office, or workout rooms because these rooms change based upon the usage of the family living there. The most versatile designs give these rooms easy access to bathrooms and equal appeal as the design allows.

The master bedroom is your reward for paying for this project. You want it to have plenty of room for relaxation with a great view for those romantic moments. A touch of privacy is desirable, so placement of the master bedroom away from other bedrooms and heavy traffic areas helps provide seclusion. Also, plenty of room for closet space is a required necessity for shopaholics.

Aside from the master bedroom, the other bedrooms need to be designed for optimum utility. Take advantage of light and views where you can and make sure each room has adequate storage space. Each wall needs to have at least two electrical sockets to accommodate technology.

Closets can gain greater clothes capacity through closet organizers. A wide variety of companies today manufacture design systems and materials for creating efficient closets that hold significant amounts of clothes, shoes, and stuff. To get an idea of available options, check out [www.californiaclosets.com](http://www.californiaclosets.com) or for you do-it-yourselfers, try [www.closetmaid.com](http://www.closetmaid.com).



### *Dining and entertaining*

Dining rooms and family rooms often center around food and need to have reasonable access to the kitchen. Decide whether a television is a critical part of your food time; otherwise you may find yourself eating on TV trays in your family room. If you want a home theater, understand that it'll have its own special needs in terms of acoustics and technology. You can start that research with *Home Theater For Dummies* by Danny Briere and Pat Hurley (Wiley).



The biggest mistake we have seen in entertaining rooms is people wasting money on built-in furniture. For storage, your needs will change — and so will the furniture. Built-in cabinets in dining rooms can go out of style or create furniture placement problems. Building furniture around TVs and stereos has proven to be a bigger waste of money as the technology changes make TV styles obsolete every seven to ten years. For example, yesterday's bulky projection TV has given way to the compact, wall-mounted flat screen, making large cabinets useless and cumbersome.

Running water will be an important consideration for entertaining. Any rooms with a wet bar need running water, drainage, and power for a dishwasher and the all-important blender for daiquiris and margaritas. Additional cabinetry may be necessary as well.

### *What's in a garage*

Some people may consider the garage as only a home for their vehicles. However, other people view their garage as a workshop and storage unit. Your garage can serve all these purposes with a little planning.



When designing your garage, think about storage access as well as the space. You want to get to everything while avoiding obstacle courses or throwing out your back. Consider dumbwaiters for storage above. If your space includes a workshop, take into account ventilation and noise. You may add extra fans and insulate with soundproofing, which adds to your comfort in extreme weather. Make these choices early on so you can plan for power and water needs accordingly.

## *The Devil Is in the Details*

Earlier in this chapter we discuss basics for the house, but really the little details will make this house something to cherish. For those of you who love detail work, these projects are just what you're looking for to personalize your new home. If you don't love detail work, take some time to get organized because you can't leave out anything. If you're completely detail-challenged, you can pay an architect or a designer to help you through this process.



Many people choose to leave the details to the contractor, but doing so often leads to misunderstandings on types of materials and costs late in the process. Avoid the headache. Make the decisions in advance and communicate with your contractor what you want.

## *Materials, hardware, fixtures, and finishes*

Check out Table 5-1, which contains a comprehensive list of items that you need to consider for your new home and different questions to ask yourself. Chapters 12 and 13 outline the installation for most of these materials as well as certain advantages and disadvantages. Use this table as a shopping list for when you're estimating your costs.

<b>Table 5-1</b>		<b>Important Details to Consider</b>	
<i>Specific Items</i>		<i>Questions to Answer</i>	
Appliances		What brands? Do you want free-standing or built-in?	
Baseboard		What type of wood? What kind of finish?	
Carpet		What type do you want? Wool or synthetic? What color? What kind of pad? How thick do you want the pad?	
Crown molding		Do you want it? What type? What kind of finish?	
Doors		What style do you want? What type? What finish? How many?	
Door handles		What style and color do you want? How many?	
Door hinges		What type and style do you like? What color? How many do you need?	
Eaves		What type and finish do you want?	
Exterior facade		What color and style do you want? What type of material do you like?	
Exterior trims		What type and finish do you want to match your exterior facade?	
Faucets		How many do you want? What styles? Do you want any outdoors?	
Fireplace		What type of face and mantel do you want? Do you want a hearth? If so, what type? Will it be gas, electric, or wood burning?	
Floor tile		What style and color do you prefer? What color do you want for the grout?	
Front door		Do you want glass or solid? What type of material, fiberglass, or wood? What color? Do you want a screen door?	

<i>Specific Items</i>	<i>Questions to Answer</i>
Handrails	What type of wood do you want? What type of finish?
Hardwood floors	What style do you like? What kind of thickness and width? What color stain do you prefer?
Heating and air conditioning	Will it be a forced air system? How many pump units? How many tons of cooling? Will you have any radiant floor heating? Will you use Zone heating and cooling for efficiency?
Insulation	Will it be rolled insulation or blown? What rating will it be?
Interior walls	What type of materials? What kind of finish?
Lighting fixtures	How many do you want? What types?
Roof	What type of shingles do you want? Do you want a flat or pitched roof?
Wainscot	Do you want it? What types of finish and wood do you prefer?
Wall tiles	Do you want them? What type (decorative, monochromatic, accents)?
Windows	What thickness do you want? What type (metal, wood, or vinyl)?

## *Make all your decisions now — Allowance is a dirty word*

Be prepared to put a lot of time into the material selection process. You'll have to make all those decisions at some point. It's never a question of how much time you'll have to spend on this shopping process; it's merely a matter of when you'll do it. Our recommendation is to select materials as early in the process as possible.



Many people spend less time on the small details during the design process and defer them until their home's basics are erected. They take their plans to the contractors who bid based upon estimates for the finish materials they call *allowances*. Doing so is a recipe for disaster. Contractors make their own decisions about the quality of materials you want and their assumptions may not be accurate. Also, you may not like what they have chosen and it may be too late to get what you really want.

In our experience, putting off the shopping for materials until the end of the project is the No. 1 reason for projects going over budget! Spend time at the beginning to make the decisions or pay your architect extra money if you're using one. You need to pick out every hinge, fixture, and appliance before you get price estimates for your project. This way you insure that all bids from

subcontractors are equal, and you can be sure of the availability of materials. Doing so also removes surprises and gives you the most accurate financial picture.



The Internet is an awesome place to find materials prices and even unique hardware. Just go to [www.google.com](http://www.google.com) and type in “hinges” or “doorknobs” (or whatever you’re looking for), and you’ll be delighted with the many choices available. You can even buy antique lamps and hardware in a cost-effective manner at auction sites such as [www.ebay.com](http://www.ebay.com)! For a more hands-on experience, you can go to showrooms, such as Ikea ([www.ikea.com](http://www.ikea.com)) or Home Depot Expo ([www.expo.com](http://www.expo.com)), to see kitchens and bathrooms and get a feel for functionality.

## *Energy efficiency — Saving the earth (and your money!)*

We can think of several areas in your home that you can enhance to conserve energy and be more environmentally friendly. We list a few here and provide additional resources in Chapter 22.

- ✔ **Doors and windows:** Today, advancements with double-pane windows and gas-filled panels reduce the ability of glass to transfer energy. Check out companies like Marvin Windows at [www.marvin.com](http://www.marvin.com), Pella at [www.pella.com](http://www.pella.com), and Anderson at [www.andersonwindows.com](http://www.andersonwindows.com) for the latest achievements.
- ✔ **Insulation:** A tight house is an efficient house (but keep in mind that a house that is too airtight can be an unhealthy house). Houses need proper ventilation so the air stays fresh and you don’t breathe your own carbon dioxide. You can research or discuss with your architect methods and materials that provide maximum insulation at a reasonable cost. In extreme environments, insulation will be the No. 1 factor for energy savings.
- ✔ **Energy-efficient appliances:** Many manufacturers make lines that focus specifically on energy savings. Many local utility companies offer rebates for choosing appliances with lower energy ratings.
- ✔ **Solar power:** Many people have saved money by supplementing their energy with solar panels. The technology has improved since people started using solar power in the 1970s. Panels have become smaller and lower profile. Many options are available through sources on the Internet.

- ✔ **Heating, ventilating, and air-conditioning (HVAC) system:** Overestimating the cost of HVAC happens often because everyone wants a more efficient air system, a reduction in noise, and comfort, especially when the weather is extreme. Larger systems may cost more, but you typically can make up the extra cost in savings when the energy bill comes around.

## *Considering technology options*

Technology has never been as much a part of individuals' every day lives as it is today. The Internet is a regular part of home life, and more and more people can work at home because of it. Custom homebuilders often tend to want to add every new piece of technology offered. Check out *Smart Homes For Dummies* by Danny Briere and Pat Hurley (Wiley) for more details about all the different choices.

Kevin has seen the pros and cons of working with house technology over the last several years, and he has a few pointers.

### *The less technology-specific the home the better*

Technology changes faster and faster today. Kevin has clients who only five years ago spent a fortune to run state-of-the-art Cat-5 computer wire throughout their homes. Today, wireless routers render the wire obsolete.

Design your house to accommodate any new technology by providing tubing (conduit) and cubbies that give you general access points to rooms in the house. Mark the access points clearly so you can always add things where you want them.

### *Make sure you have ongoing support*

Technology companies come and go. Sometimes the most innovative go up in a ball of fire the fastest. Whatever technology you install in the house needs to be maintained and serviced. If the manufacturer goes out of business, your technology may be as useful as that 8-track tape player in your attic.

### *Watch the budget*

Your house project may take years, and new features that are better than what you install will be available. Buy only what you're truly likely to use. Kevin has one client that spent more than \$350,000 making his house a smart house. By the time the three-year project was finished, most of the technology could have been installed for a mere \$35,000. Talk about one unhappy client!





## Chapter 6

# Engineering and Plan Approval: Bureaucracy Made Somewhat Easy

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### *In This Chapter*

- ▶ Reading your plans
  - ▶ Getting approvals
  - ▶ Obtaining permits
- 

**W**ouldn't life be great if you could simply sketch your house on the back of a napkin and the contractor would magically build exactly what you had in mind? Whether designing a log, stick built, or timber frame home, sadly the process is a bit more complicated; your project requires outside expertise and approvals. In this chapter we take the mystery out of looking at blueprints and plans. We talk about engineering the working drawings. We also explain the design review process and discuss acquiring and paying for permits.

## *Understanding Plans and Blueprints*

If you have ever built model cars or airplanes, you know how important the instructions are. Nothing gets you into trouble faster than trying to assemble that model by looking only at the picture on the box.

Obviously, having instructions when building a new home is essential. However, because a house is a complex structure made of many different systems, your instructions (or plans) need to include many different drawings. A typical set of plans will include 30 to 50 pages of specific instructions on how to build your house. The plans first include a set of preliminary designs or *prelims*. After these prelims are approved, the engineer prepares the working drawings for constructing the house. (See “Working drawings: The how-to-build-it papers” later in this chapter for more on working drawings.)

## Why are blueprints blue?

*Blueprint* is a long-surviving term, more than 150 years old, that comes from the fact that reproductions of plans for construction were always blue with white lines representing the drawings and words on the page. The construction industry needed a way to make exact replicas of large drawings with exact measurements because the corner Kinko's was unavailable. Architects and draftsmen first drew their plans on tracing paper. The translucent paper was placed on light-sensitive chemically reactive paper and soaked in chemicals that turned all

the light exposed areas blue and left the lines white. This system was a cost-effective method for creating multiple sets of perfect duplicates suitable for construction. Later, the process was reversed to create blue-line prints where the lines are blue and the paper is white. Although blueprints and blue-line prints are still used today, most architects now use Computer Aided Design (CAD) systems and simply print plans on large printers. The term blueprint has stuck and now means any sort of master plan.



Architects and engineers often draw plans in quarter-inch scale, meaning that each  $\frac{1}{4}$  inch on paper represents 1 foot in real life. You can read the drawing measurements easily with a ruler by measuring any line and dividing the number of inches by 4 to understand how many feet long any straight line will be in real life.

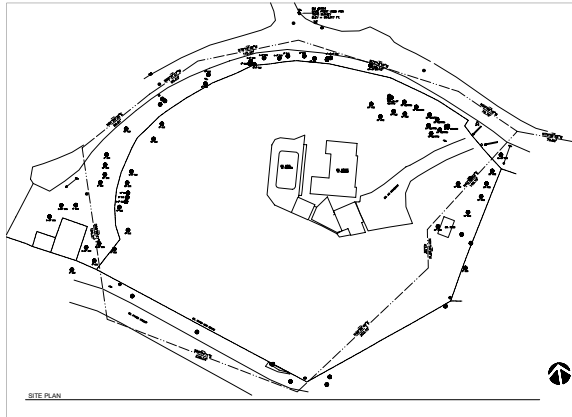
## *Prelims — Floor plans, site plans, and elevations*

The first designs will be rough sketches and drafts drawn by an architect or designer. They may include scratch drawings and renderings, which are an artist's version of what the house may look like. If you buy plans from a book or online as discussed in Chapter 5, you can skip the rough sketch phase of the process. Plan software also discussed in Chapter 5 provides a neat way to try different floor plans with ease.

As soon as you and your architect, if you're using one, have made some basic decisions on style and size, the architect will draft preliminary drawings. These drawings are necessary to show the house in three dimensions. The prelims will be used primarily for making initial decisions, such as room placement and size, with your architect, as well as preparing for the initial design approval process. (For the nuts and bolts on the design approval process, check out "Submitting Your Prelims for Approval" later in this chapter.) Creating these prelims is an ongoing process of reviewing drawings and making changes. If you're buying plans, the plan company provides you with the prelims. If you're using a software program, the prelim creation is your responsibility.

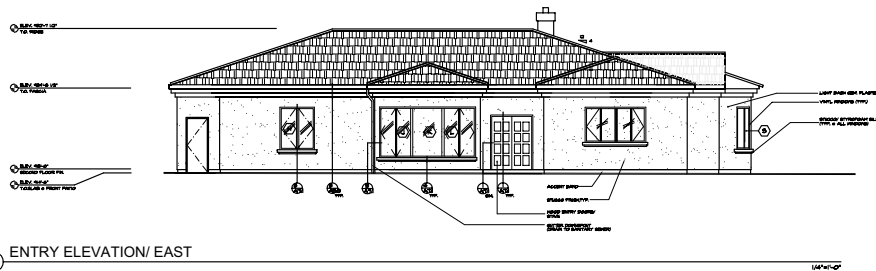


every detail for construction including where to put the plugs and switches as well as the number of rafters in your roof. Furthermore, the working drawings include all the technical specifications and requirements for engineering and compliance with building codes. Each of the systems in the house is specified in the working drawings.



**Figure 6-2:**  
Example of  
a site plan.

*Courtesy of Tecta Associates Architects, San Francisco*



**Figure 6-3:**  
Example of  
an elevation  
drawing.

*Courtesy of Tecta Associates Architects, San Francisco*



In addition to the floor plans, site plan, and elevations, a typical set of working drawings has individual drawings for each structural system of the house. These individual working drawings

- ✔ Provide all the technical specifications necessary for contractors and subs to bid on your project. Each different section goes out to a different craftsman so they can determine the time and materials necessary to complete the project.
- ✔ May include some variations if you're working with a design-build firm like we discuss in Chapter 5. Because the same firm will be handling both the design and building process, it may combine or reorder some of the technical pages to fit its process.

- ✔ May contain other pages that detail specific construction of parts that require extra detail such as unique staircases or particular architectural elements.
- ✔ May also include pages specifying energy calculations where required by the building department.

Working drawings generally include the following documents drawn in equal scale:

- ✔ **Architectural plans:** Site plan, floor plan, elevations, cross sections, wall sections, schedules of materials, and details
- ✔ **Civil plans:** Site plan, grading plan, and details
- ✔ **Electrical plan:** Outlets, switches, and lighting plans (see an example in Figure 6-4)
- ✔ **Landscape plan:** Landscaping layout, irrigation plans, schedules, and details
- ✔ **Mechanical plans:** Furnace and ducting plans and details
- ✔ **Plumbing plan:** Plumbing riser plans and isometrics, and details
- ✔ **Structural plans:** Foundation plan, framing plan, cross sections, and details

## Building codes and ABCs

Building codes are rules and guidelines that specify how construction should be completed so that buildings will be safe. They address issues such as the requirements for electrical wiring, the size of pipes, how far to place framing posts, and so on. Unfortunately, no one standard building code exists for the entire country (or for the entire world), although it would certainly be easier if there were. Most municipalities have adopted a regional code and then created variations as required for their area.

In the United States, the basic codes come from the following published codes:

- ✔ **The Uniform Building Code (UBC):** Widely used in the West.
- ✔ **The Standard Building Code (SBC):** Widely used in the South.

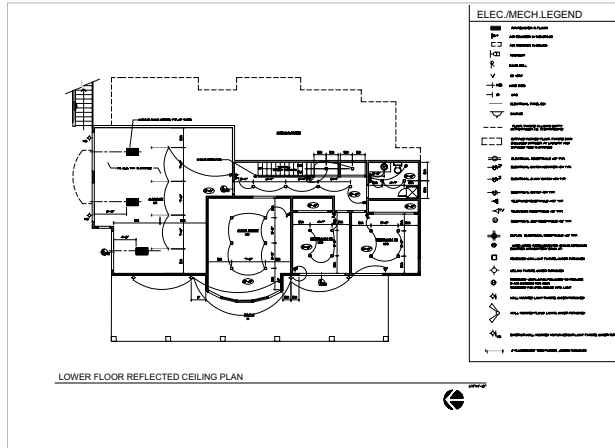
- ✔ **The National Building Code (NBC):** Until recently, widely used by everyone not using the UBC or SBC.

- ✔ **The International Building Code (IBC):** The latest code, being adopted by everyone in all regions.

Your contractor, subs, architect, and engineer need to be knowledgeable with the codes for your area. Some regions, such as California, have more stringent code requirements than others due to seismic or other environmental issues. If you want to find out more about building codes or check a specific code, try [www.codecheck.com](http://www.codecheck.com).

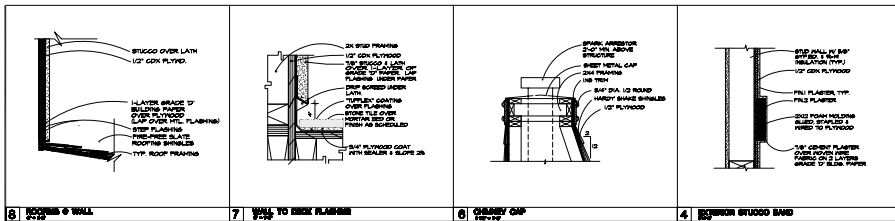
You can see an example of how these system drawings are isolated in Figure 6-5 so each sub can focus on his or her work.

**Figure 6-4:**  
This electrical plan shows the electrician where to wire the house for sockets, switches, and junction boxes.



Courtesy of Tecta Associates Architects, San Francisco

**Figure 6-5:**  
Each box explains to the sub specifically how to construct an individual section of the house.



Courtesy of Tecta Associates Architects, San Francisco

## Working with the Building and Planning Departments

Many of the nightmare stories you may hear about custom homes stem from dealing with local government during the plan approval process. The local county or city has to approve your designs and make sure the plans fit with their rules and regulations in a process called *plan check*. You have to provide to the local government offices all your plans and anything else they may ask for, which varies with every department in every municipality.

If everything goes smoothly, then you can be ready to break ground in three to six months from the time you first call your local planning office. (Of course, this time frame varies widely depending upon where you live.) If you hit a snag, then all bets are off. Kevin has clients who have battled building and planning departments for more than a year. The best way to prevent problems is to work with experienced architects, engineers, and contractors (if involved at this time) that know the department you're submitting to. These professionals can use their relationships and knowledge of the local government inner workings to chart the fastest, smoothest course for approvals and save you from making costly mistakes.



Here are additional pointers to remember to make the process of working with the building department go smoothly, especially if you have a problem:

- ✔ **Keep communicating.** First and foremost, keep the lines of communication open. The permitting process is all about passing information back and forth. Ask a lot of questions so you're sure you understand how everything works.
- ✔ **Be complete.** Most building departments hand out or post online the information required to apply for a permit. Have all your information together in a nice neat package. Make sure it's complete when you turn it in. If you piecemeal the process, you'll frustrate the clerks, inspectors, or plan checkers and they won't be able to make informed decisions — possibly leading to costly delays.
- ✔ **Deal with one person.** One helpful person can make all the difference in a building or planning department. Dealing with the same person can keep you from having to explain your situation again and again. Find a person that you can work with. If you respect this person and give him or her a pleasant experience, then he or she is more likely to give you one.
- ✔ **Have a single point of contact on your end.** Plan-checkers, clerks, and inspectors get frustrated and confused by getting what can be conflicting information from the architect, the contractor, and the client. Pick a contact on your side, keep in touch, and trust in your contact. Most people choose to make the architect or contractor the contact because they usually have longstanding relationships with the local employees.
- ✔ **Be persistent.** Most building and planning departments are underfunded and understaffed. They're busy, and there is always a bigger problem to take your place. Don't be afraid to call regularly to get the response you want. Be careful not to pester needlessly however. Pick your battles, but when there is something you really need, press the issue. Letting them know the realistic timelines at stake helps so they can set priorities in their workload.

✔ **Don't be intimidated or intimidating.** These people are civil servants; they're there to help you and want to do so. Don't be afraid to be ignorant of the building process, and don't be afraid to ask questions. At the same time, treat everyone in your building department with courtesy. Even if you hit a roadblock, you'll get further in the process with calm discussion than with angry theatrics. Smiling and saying thank you goes a long way in reminding people that you're human. A friendly tasteful joke once in a while may make that civil servant the inside friend you need.

## *Submitting Your Prelims for Approval*

Before you spend thousands of dollars engineering plans and creating working drawings, you'll want to get approvals for the preliminary design of your house.

Generally, in rural areas, the design approval process is simple and has minimal limitations. In rural areas, houses are typically separated by vast acreage and the county is seldom concerned about what your house looks like as long as it meets the safety and building code requirements.

But if you plan to build in a higher density neighborhood or planned community, the guidelines can be strict and the design-approval process exhausting, especially if you're looking to bend the rules. Keep reading for info about the design review process.

## *Addressing grading, septic, and well issues*

Before you submit your prelims for approval, the county may require special separate permits for specific items such as grading, well, and septic systems. These approvals and permits may need to be handled by you, your architect, or your contractor before the house plans are completed based upon the needs of the lot. You may encounter some restrictions with grading, well, and septic systems. For example, the building department may only issue grading permits at certain times of the year to prevent erosion when grading a hillside prone to geological issues.



Find out about any grading restrictions in your area before starting the permitting process. By taking time-sensitive issues into account in the beginning, you can avoid stopping and starting your project, which can create financing and labor problems down the line.



Wells and septic systems need to meet county standards for habitability as well as environmental concerns. The county may have minimums for water pressure allowable for the size of the house. A similar issue can exist for septic systems. If the soil doesn't support a standard system, the county may require a more expensive engineered system or restrict the size of the house.



Exploring these issues first with your architect and other professionals who can certify wells and septic tanks can save you time and money. Otherwise you may run into a brick wall on your approval and have to redesign the house from scratch or — worse — find out you can't build at all.

## *Understanding design guidelines*

Have you ever wondered why all the houses in a neighborhood seem to have a similar look and feel? The similar look and feel isn't by chance. Neighborhoods, cities, and counties often develop specific guidelines that govern what you can build and how you can build it. Furthermore, other agencies such as the Coastal Commission may also have to approve your design if you're building near the coast. You can obtain these published planning and building department regulations from your local planning and building departments.

You also need to be aware of other guidelines that were put in place when your lot or neighborhood was created. You can find some of these rules in the covenants, conditions, and restrictions (CC&Rs). You should have received a set of the CC&Rs when you bought the lot. If you didn't, you can ask the title company from your purchase to get you a copy for free. Subdivisions older than 50 years likely have a minimal set of rules. They may not have CC&Rs that are pertinent.

Newer subdivisions are usually developed with specific themes. Seaside areas or golf course developments may have very restrictive guidelines to make sure you're staying within the theme of the development. No one in a planned Spanish-style development wants to drive by a giant Cape Cod house everyday. You can obtain these rules from the homeowner's association (HOA). Depending upon your neighborhood, the guidelines may include the following:

- ✓ Architecture style
- ✓ Drainage
- ✓ Environmental issues
- ✓ Exterior finish materials
- ✓ Height of the house
- ✓ Landscaping restrictions

- ✓ Minimum and maximum size of the house
- ✓ Paint color
- ✓ Types of the following building materials:
  - Doors
  - Roof
  - Windows

Developers and HOAs establish guidelines to ensure that no one house is imposing upon the pleasure of any other homeowner in the neighborhood. Most likely, after you have successfully built your house, you too will adopt a NIMBY attitude (which stands for Not In My Back Yard) and will become a vigorous defender of your neighborhood's guidelines.

## *Requesting variances and exceptions — Don't be Don Quixote*

Some smaller cities and neighborhoods have volunteer design review committees, whose members may be appointed or elected by the community. Although such committees may have a government employee involved or in attendance, most are dominated by residents concerned with the preservation of their neighborhood's particular aesthetic feel. Design review committee members are passionate about determining what other people's houses must look like, so you'll need approval from this committee to build your new home. If you're lucky and careful, the process can be short and sweet; if you're not lucky — or worse, careless — the process can take far longer and be more harrowing than the building of the entire home itself.

Because you're building a custom home, you have already made a statement that you're dissatisfied with the homes already available in your neighborhood or community and want something more unique to suit your taste. As a result, design review isn't likely to be a picnic. For design review, you'll submit your preliminary plans to the design review board, neighborhood association, and/or planning department to get approval for the basic design of the house. They will review the plans and return them to you with a list of everything they don't like. *Subjective* guidelines such as style and colors may provide for negotiation for an *exception*. Objective rules such as exceeding height limits likely require a *variance* to the guidelines.

The best way to deal with variances is to design a house that doesn't require them. Working with an architect familiar with the community's regulations may help. If you're looking at too many restrictions for what you want to build, you may want to consider a different piece of land entirely.



No one has the right to a variance or exception. You can request it but it may be turned down. Some people choose to fight restrictions legally by showing evidence that similar variances have been granted in the past. If you undertake such a battle, you may win but at a great expense of time and money. Remember, even if you take your case to court, there's no guarantee you'll win. Furthermore, you may ultimately win a long drawn-out design review battle and end up losing the war. Don't forget that the design review board is comprised of your neighbors. A protracted battle filled with hate and lawsuits can make for a rather hostile housewarming when it's time to move in.

## *Not so fast — Acquiring neighbor approval*

Just because the local design review association or planning department says they like the house doesn't necessarily mean you're home free. In many cities you still have to get neighbor approval before presenting your project to the design review board or planning department. Getting neighbor approval most often occurs when you're building in a long-established neighborhood, but not necessarily. This neighbor approval process gives you the opportunity to inform your neighbors and prepare them for the new addition to the neighborhood before you submit your plans. (The city will tell you if you need neighborhood approval.)

As a part of seeking this approval, you may be required to erect *story poles*. Story poles are wooden boards that outline the perimeter and height of the house as shown in Figure 6-6. These poles are required to stay in place for a designated period of time while your soon-to-be neighbors assess if your house will block their sun exposure, lake views, and so forth. Your neighbors will then be given the opportunity to challenge the approval of your building plans, which can turn into an unpleasant experience.



The earlier you establish a friendly, working relationship with your neighbors, the better your overall custom home experience will be. Just by planning ahead, you can reduce the stress level when submitting your plans and possibly start to develop good relationships with your new neighbors. Consider the following:

- ✓ **Take into account your neighbors' sight lines and exposure before you commit to the design.** Ask if you can look through their windows to see the impact on their property.
- ✓ **Put yourself in their position.** What would you think of living next door to your planned home?

- ✔ **Get their feedback and support for your project.** Kevin has one client who threw a wine and cheese party for the neighbors so they could come and see the plans before submitting. He had rousing support at design review. This process has been a favorite of architects he has worked with as well.

**Figure 6-6:** Story poles are required in some cases to let neighbors know how your house will affect sight lines and aesthetics.



*Courtesy of John Stetson*

## *Gathering the Permits You Need*

After the prelims have been approved, you can start moving down the permitting path. Don't worry; this process is a lot more cut-and-dry than the design review. The building permits are there to make sure that your final plan meets with the minimum standards required by your local city or county. The rules may be set for reasons of safety, logistics, or for environmental or other reasons. (No one has come up with a code to restrict teenagers to their rooms yet, but who knows, maybe soon.)

You or your architect will hire engineers to make sure you're meeting the needs of your local government and help create the working drawings. The permitting process isn't always a short one. If everything goes smoothly, you may get through it in a few months. Some processes can take more than a year with complications or bureaucratic difficulties.



Many building departments have a preliminary review process. For a fee, they look at all your working drawings after design review or before you formally submit the information to the planning department. They'll let you know if they notice anything questionable or potentially against code so you can fix it first. Utilizing the preliminary review process can get you through the formal process fast and easy.

## *Submitting and revising the working drawings*

After the designs are approved and the working drawings finished, you, your architect, or your contractor (if involved at this point) submit the working drawings to the building department with appropriate fees required for application. These fees get the ball rolling.

The plan checkers scrutinize the working drawings to make sure they meet all the local codes and requirements. The plan checker marks the working drawings with red pencil for correction or in rare cases turns the plans down for permit. (If turned down flat, you'll need to have the plans re-engineered.)

You, your architect, or your contractor, if you've hired one yet, can pick up the marked plans at the building department. The architect and engineer make the requested changes to the working drawings and resubmit the plans to the building department.

If the plan checker still isn't satisfied, he'll red pencil the plans again and request they be fixed again. This process continues until the plan checker is fully satisfied, at which point the plans are officially approved.

In some areas, you may need to go through this process more than once. The plans may require review by a local city department and a county department. Different local governments have different jurisdictions for code, so they'll dictate their own approval process. Discuss the plan check process with your architect and engineer so you're clear on the steps and timing.

## *Picking up permits and paying the fees*

After the building department has fully approved your plans, you or your contractor, if he's involved at this point, can pick up the permits.

You'll write a large check for all your permits and the remaining fees and pick up the permits so you can break ground. The costs vary widely from area to area, as do the names for the fees, but you can expect your permits and fees to cost between \$3 and \$10 per square foot of building area. You'll have to pay these fees in full before you're allowed to begin building on the property. Often these fees cover general expenses for the neighborhood's local infrastructure as well as overhead for the local government. (Remember, the city or county has to cover every cost and support the numerous staff members necessary to run their departments.)

The following list contains many of the fees you can expect to pay:

- ✓ Appeal fee
- ✓ Building permit
- ✓ Design review fee
- ✓ Drainage study fee
- ✓ Grading permit
- ✓ Land use permit
- ✓ Parks and recreation fee
- ✓ School fee
- ✓ Tree permit
- ✓ Variance fee
- ✓ Walkway fee

Although the cost of these various fees shouldn't be deal breakers for you, be sure you have sufficient funds budgeted for them and that you're prepared to pay when the time comes. Even though you may have to pay these fees out of pocket, you may be able to reimburse yourself through your construction loan if you included them in your budget. See Chapter 9 for more details on how these fees fit into the construction loan budget. These fees can often be reimbursed immediately by showing the bank the receipts. We talk about reimbursing these fees in Chapter 10.

# Part II

# All You Need Is Dough: Financing Your Custom Home

The 5<sup>th</sup> Wave

By Rich Tennant



"I'm well aware that we ask for a lot from our construction loan applicants, Mr. Harvey. However, sarcasm is rarely required."

## *In this part . . .*

**Y**our custom home project needs plenty of money. Either you have the cash or you don't! In this part, we explain the need for cash and how to determine if a lender is necessary. We walk you through the entire construction lending process including getting approved and picking the right loan. We also show how you get your money from the lender during the building process.



## Chapter 7

# Cash Is King: Using Debt to Your Advantage

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### *In This Chapter*

- ▶ Figuring out your cash needs
  - ▶ Analyzing how your new home and finances fit together
  - ▶ Managing the cash
  - ▶ Protecting your home as an investment
  - ▶ Postponing some financial decisions until the house is complete
- 

**T**his chapter may be one of the most challenging to accept, but within its pages, you can find some of the most important concepts in this book. A construction project lives and dies on the availability of funds. Without access to cash when it's needed, a construction project will quickly come to a grinding halt. Most people want to be fiscally conservative when dealing with a large financial project like building a home. The challenge, however, is in understanding exactly what fiscal conservatism is really all about.



To make good decisions with your finances, spend some serious time educating yourself. No need to bury your head in the sand from the fear of numbers; you can access all kinds of information on the Internet and through the help of financial professionals. The more you find out about financial management, the better equipped you'll be to make the right decision for your situation.

In this chapter, we explain why having adequate cash on hand is so important. We also help you put borrowing in the proper perspective, and explain concepts that can help you protect your investment and manage your cash. Finally, we give some tips for deferring major financial decisions until the end of the project, when you have the information you'll need to make a good decision.

## Accepting the Need for Cash, Cash, and More Cash

You may be wondering why cash is so important if you're already planning to get a construction loan and not relying on savings to fund building your new home. The answer is simple: Whether or not you borrow money, your custom home project will suck up cash like a vacuum cleaner. If you have enough money, you'll be fine, but run out of cash and you'll be in a big time world of hurt.

A *construction loan* does cover a significant portion of the funds to build your home, but you'll also face some significant restrictions and procedures for getting that money, so having extra cash on hand will keep the project moving. Not only that, but you need some cash before your loan is in place to cover expenses like permits, and after it's complete in order to pay for moving in and landscaping. In addition to your construction loan, you may end up needing as much as 40 percent of your total budget in cash to make the project work. We explain how construction loans work in Chapter 8 and discuss how you get your money from construction loans in detail in Chapter 10.

If you're still not convinced, consider the following reasons why extra cash is necessary even if you're financing your project through a bank:

- ✔ **You need a down payment for your land.** Chances are, when you purchase your land, you'll need to make a down payment and pay for closing costs. See Chapter 3 for details.
- ✔ **You need to make the loan payments and pay taxes on your land until the construction loan is in place.** It may take several months from the time you buy your land before you're ready to build and get a construction loan. You'll have to make payments on your land loan and pay property taxes while carrying the payment on your current home.
- ✔ **You need to pay the soft costs.** You have to pay for *soft costs*, such as the plans, engineering, and many fees for permits before you can fund your construction loan. See Chapter 6 for details about soft costs.
- ✔ **You need cash to close the construction loan.** Your construction loan may not be big enough to cover all your costs for the project. Also, the bank will want to see money in the bank beyond what is necessary for the project for qualifying. See Chapters 8 and 9 for details.
- ✔ **You have to pay the monthly costs during construction.** Your loan may have an *interest reserve* (or a pool of money set aside) to cover the construction loan payments as described in Chapter 8, but you still have to pay for property taxes and homeowners' fees as well as the house payments where you're currently living.

- ✔ **You need to fund the work between the construction *draws* (fundings from the bank).** The construction lender won't give you loan proceeds for a particular part of your project until the work is done. You'll have to put the money upfront, and be reimbursed by your construction lender with the loan proceeds later. See Chapter 10 for details.
- ✔ **You want to upgrade as you go.** You may want to improve certain items as you see the house come together, for example, substituting granite kitchen countertops in place of the Formica ones you originally specified. Because you can't increase the construction loan after you fund it, you have to pay for the upgrades out of pocket.
- ✔ **The project costs more than you budgeted.** Do you want some sobering news? Approximately 95 percent of custom home projects go over budget. (Can you say ouch?) And when a custom home project goes over budget, guess who pays? You. Although you may be the lucky 1 in 20 who doesn't go over budget, do you really want to take the chance with the largest investment you'll probably ever make in your entire life? We didn't think so!
- ✔ **Landscaping, decorating, furnishing, and moving expenses.** These items probably aren't included in your construction loan budget. Even if landscaping and hardscaping *are* included, the decorating of a new home can cost a pretty penny.
- ✔ **Something goes wrong.** Always remember Murphy's Law: If something can go wrong, it will go wrong. Anything from your contractor winning the lottery and abandoning your project to August snowstorms in Arizona can unexpectedly create the need for more extra cash. Just remember, as Yogi Berra said, "It ain't over til it's over!"

## ***Breaking the Emotional Barriers — This Is Not Your Father's Depression***

Many people approach their finances today using philosophies that have been passed down through many generations. For example, the concept of using extra cash to pay off your mortgage early was based on Depression-era economics of the 1930s. In those days, banks were unsafe, Social Security was merely a twinkle in the eye of President Franklin D. Roosevelt, and owning one's home free and clear was the only financial hedge most people could rely on.

Of course, times change. Banks are safe, most people have retirement income and/or Social Security to help out as they grow older and leave the workforce, and a home is merely one of several assets that most people keep in their financial portfolios. Are you living your financial life based upon the philosophies of the 1930s?

Although your elders may have handed down lessons to you, you also need to realize that today's economics are somewhat unique to the last 30 years. Financial structures today are vastly different than they were — even a couple of decades ago — and all different kinds of new tax laws and investment strategies didn't even exist in Grandpa's time.

## *Evaluating real estate within your net worth*

Calculating your net worth can give you a good perspective on your finances. Many people make the mistake of separating their real estate — particularly their homes — from the rest of their assets. If you're like most people, your house is probably your single largest financial asset. For that reason alone, don't ignore it. Chances are, of course, your mortgage is also your single biggest financial liability. Understanding your asset and liability picture is important to gaining the proper perspective for making major financial decisions such as the structure of financing a custom home. Use the following simple method for calculating your net worth:

**1. List all your assets with their values.**

Make sure you include the current sale value of your existing house, the resale value of your cars, cash on hand, and any stocks, bonds, cash-value insurance policies, or retirement money you may have squirreled away.

**2. Add up the total dollars of all your assets.**

**3. List all your *liabilities* (money you owe).**

Don't worry about the monthly payment amounts, instead, write down the outstanding balances of your mortgage, car loans, student loans, credit cards, and other debts.

**4. Add up the total dollars of all your liabilities.**

**5. Subtract the liability total from your asset total.**

This amount is your net worth.

Now that you know your net worth, you can assess how your real estate fits in the picture:

**1. Estimate today's value of all your real estate.**

**2. Add up the amounts of all your mortgages.**

**3. Subtract the mortgage total from the value and this amount is your net equity.**

**4. Take your net equity and divide it by your net worth.**



If the number is greater than .45, then you have too much of your net worth tied up in equity. Even the most conservative investors don't like to keep all their eggs in one basket. Talk with your financial advisor, accountant, and loan officer about the methods for increasing your *liquidity* or available cash and the benefits of doing so.

## *Acquiring secured debt can be good*

Everyone agrees that too much debt can be terrible, but we can think of several good reasons to borrow money if you know you have the ability to pay it back. Unfortunately, debt can easily get out of hand for some people. All debt, however, isn't treated the same.

- ✓ **Unsecured debt** is cash loaned to you strictly on your promise to pay it back with interest (and any other fees that you and the lender mutually agree to). Repayment of the loan isn't guaranteed by any of your property (home, automobiles, boats, and so on). Unsecured loans generally have interest rates significantly higher (the words *loan shark* may come to mind in some cases) than the prevailing prime rates that banks charge their best customers.
- ✓ **Secured debt** is a different animal altogether. Repayment of the cash loaned to you is guaranteed by some item of your property like a car or your home. When debt is secured against an asset, it simply means you're making the asset more liquid. The asset still exists to pay back the debt, and very few banks will allow you to borrow more money than exists in the asset. In other words, you're really borrowing your own money out of the asset.



Because the loan is secured, the lender has less risk and will generally loan you the money at lower interest rates. You can also receive government subsidies for borrowing against assets such as real estate.

## *Getting on the same page — How banks evaluate risk*

Lenders don't think secured debt is bad. In fact, they'd rather bank on someone with secured debt and liquidity (cash in the bank) than someone who has no secured debt at all. Consider this example:

*Two neighbors walk into the local bank. Bill Smith has a home worth \$400,000. He has paid off his home and has \$20,000 in the bank. His net worth is \$420,000. Jane Clark, Bill's neighbor, also has a net worth of \$420,000, but Jane's net worth is structured differently. Her house is also worth \$400,000. But Jane has a mortgage for \$300,000, and she has \$320,000 in certificates of deposit and mutual funds.*

Who gets the bank's attention?

The bank offers Jane its best signature loan for \$200,000. She can have the money today with five minutes of paperwork and no costs. Why does Jane get this special treatment? Jane is no risk to the bank; she has ready cash available to pay back her loan if necessary.

Bill, however, is sent down the hall to the mortgage department. He doesn't get a quick loan. Instead he has to apply for a secured mortgage, and then wait for his money while the bank verifies all his information and performs an appraisal on the house. Bill has no means to pay back the loan unless he sells his house, so the bank wants to secure the loan to his house to protect its investment.

So, even though on the surface Bill seems to be the most prudent investor, he's actually a walking, talking risk in the eyes of the bank.

How would you look to your lender? Consider changing your financial profile to look more like Jane's.

## ***Changing perspective — Home equity isn't a savings account***

Many people have the erroneous belief that paying off their home is just like putting money in a savings account. Nothing could be farther from the truth. Understanding this concept is important so you can make the right long-term decisions regarding your custom home financing. Your home is *not* a bank!

Why not? Because

- ✔ When you put money into a savings account, you can withdraw the money whenever you want. The only way to draw money out of your house is through some sort of mortgage or credit line, which requires time and often some costs.
- ✔ You can quickly move money in a savings account to better investments as markets change. Equity is stuck in the house and can only be acquired at prevailing rates.
- ✔ You can take out money in savings in any amount — no matter how small — and at your discretion. You can only remove equity in large amounts and at the discretion of the bank willing to loan money to you based upon whether or not you qualify.

## *Understanding the benefits of liquidity*

When it comes right down to it, good old-fashioned fear is the biggest motivator for tying up cash in the home. Some people are afraid they might squander their money, so they increase their payments. Others are afraid of losing their job, so they increase their payments. Many are afraid of the economy changing, so they increase their payments. To counter those fears, consider some basic benefits of keeping your cash liquid instead of burying it into your house:

- ✔ **If you lose your job:** If you lose your job, you'll need to worry about a lot more than just making your house payment. Borrowing extra money on your mortgage for the sake of having cash in the bank can be an excellent form of security. Even though having a house payment that is \$500 cheaper may make a financially difficult situation a little easier for you, having a higher monthly payment with \$100,000 in the bank will make life a lot easier while you work on finding a new job. You can take your time to assess the situation, and you can afford to take an extra few months to find the right job — instead of feeling like you have to take the first offer to come along.
- ✔ **The economy:** If the economy goes south, then you have cash on hand to bail you out of any situation. If your house decreases in value, so what? You already have the money to use as you see fit. If the interest rates are on the rise, all the better for you because now you can get a higher return on your cash.
- ✔ **Cash squandering:** Getting a professional to help manage small portfolios of money isn't easy. The more money you have to invest, the better caliber professionals will be available to you. They earn a percentage of your portfolio's growth, so they'll work hard to help you save and invest in ways that will benefit you both in the long run.



All this advice assumes that, instead of spending every extra bit of cash like a drunken sailor, you put it aside into a savings account, stocks, a money market fund, certificates of deposit, or other liquid assets. So, instead of running out to buy an expensive new sports car, taking an around-the-world ocean cruise, or gold-plating your plumbing faucets and fixtures, invest your money wisely!

## *Okay, So You Have All This Cash — Now Manage It*

So now you have the cash, and with it comes the added responsibility of managing it. Having wealth can be a pain initially, but have no fear; excellent resources are available. Start with the terrific book, *Investing For Dummies* by

Eric Tyson (Wiley). Then check out some of the many excellent online resources to help you discover how to manage your money. Our favorite is [www.motleyfool.com](http://www.motleyfool.com).

## *Finding and working with a financial advisor*

If doing your homework is too time consuming or mind boggling, then don't hesitate to work with a professional financial planner. After you have a decent size portfolio, getting the attention of an experienced professional to help you manage your dough should be fairly easy.



Ask friends and family that are financially secure whom they use for financial planning. Many qualified, experienced professional money managers are out there, but many of them aren't up to the task or don't have your best interests in mind. Do your homework. Ask for referrals and references and check them out. You want someone who will ask you a lot of questions to prescribe the best options. Three basic types of financial advisors are available to you:

- ✓ **Fee planners:** These planners work on flat fees rather than commission-like insurance-based advisors and stockbrokers, and therefore they aren't necessarily tied to selling you any particular kind of investment. Many people believe the lack of commission makes them more objective. Others argue they aren't motivated to earn you the best yields. For more information on fee planners, check out the National Association of Personal Financial Advisors Web site at [www.napfa.org](http://www.napfa.org).
- ✓ **Insurance-based advisors:** These advisors work for insurance companies or independent insurance brokers, and their primary focus is using insurance policies as investment vehicles. They're often experts in estate planning.
- ✓ **Stockbrokers:** These advisors deal primarily in stocks, bonds, and mutual funds (and they're in business primarily to sell stocks, bonds, and mutual funds). Many larger brokerages have expanded their services to provide other banking and insurance services.

After you find a few financial planner candidates, investigate their credentials and approach. You want to work with someone that takes everything in your financials into account and who is knowledgeable in all kinds of different investments. For example, you'd be surprised how many advisors have little knowledge in real estate.



Stay away from brokers just trying to sell you the hot stock *du jour*. And be aware that there is no way to magically make money. The best advisors advise. Find someone that can spend his or her time educating you so you can make the decisions.





If you can't find one person you trust and you have more than \$100,000, spread it around. Try splitting your portfolio among a couple of advisors and see which one performs the best over time. As soon as the trend becomes clear, then shift your assets to the financial planner who does the best.

## *Diversifying your portfolio*

A good financial planner may suggest several strategies, but the primary focus needs to always be *diversification* — splitting your money over many different types of investments. Why? Because no high-performing investment stays that way forever. Diversifying your assets can protect you when a market goes through changes.

Some markets work in the opposite direction. For example, when interest rates rise, the stock market may fall, and vice versa. By investing in a number of different kinds of assets, you can protect yourself from volatility in a particular market and gain a steady return. Studies have shown that well-diversified portfolios have consistently earned 8 to 10 percent during any ten-year period of time in history — from the time of the Great Depression through today, even accounting for the bursting of the stock market Internet bubble. Work with your advisor and discuss the best way to divide your assets, keeping tax ramifications in mind. Different options include

- ✓ Commodities (such as oil, orange juice futures, and pork bellies)
- ✓ Corporate bonds
- ✓ Government/municipal tax-free bonds
- ✓ Large-company stocks
- ✓ Precious metals (gold, silver, titanium)
- ✓ Real Estate Investment Trusts (REITs)
- ✓ Small-company stocks



Many advisors recommend investing in mutual funds and annuities because they're a single fund that mixes many categories for you. You can focus these funds toward income or growth. You can also look at an established fund's *prospectus*, a pamphlet explaining all the management details and risks associated with a fund, to see how the fund has performed over time and who is managing the fund.

## *Exploring alternative investments*

Other types of investments can provide good returns outside the standard investment markets. Ask your financial advisor about the risks and benefits

of investing in some alternative investments. Check out the following investments that are worth exploring:

- ✔ **Equipment-leasing funds:** Usually available only through a financial advisor, you loan money secured against business equipment, such as computers, furniture, tools, and other assets.
- ✔ **Federal tax credits:** Believe it or not, you can buy someone else's tax benefits and the government guarantees them.
- ✔ **Notes:** Just like a bank or savings and loan, you can loan money to people and get paid interest in return for the risk you take. A *note* is the written promise by a borrower to pay you back with interest. To protect your investment, you can secure notes against real estate holdings.
- ✔ **Limited partnerships:** A limited partnership is a group of two or more people who work in partnership to invest in assets such as large commercial buildings, apartments, and shopping malls. Limited partners, by definition, have only limited say in the operations of the partnership.
- ✔ **Other real estate:** Many people opt to take their money and buy rental properties. See [www.stratfordfinancial.com](http://www.stratfordfinancial.com) for more information on this topic.



You won't find a shortage of investment choices. Not all are financially sound or make sense to every investor. Investigate each one thoroughly and leave yourself with options. Protect yourself by only investing in something you can effectively explain to someone else.

## Turning Your House Into a Money-Making Machine

For most people, their house is more than just their home. It represents their single largest investment, as well as their largest source of long-term income. When building a custom home, consider your home an investment. With any investment, you need to make decisions aside from whether or not to invest, such as how to leverage using financing and how to take actions to maximize the return. Many of the questions require research and conversations with professionals like certified public accountants (CPAs), real estate agents, and loan officers. Understanding how a home works as an investment will better prepare you to make the right financial decisions on your custom home to help you maximize your investment return.

## *More house for less cash — Benefiting from leverage and appreciation*

The way people make money on their home is through *appreciation*, which is a return on your investment — the reward for taking a risk with your money. With very few exceptions, you can count on real estate to go up in value over long periods of time. Although appreciation isn't always consistent from year to year, short of some local economic catastrophe, you can typically expect to see the value of your home rise at least 3 to 5 percent per year. Some parts of California and New York have risen more than 20 percent annually in recent years.



You can increase the return on your investment with something called *leverage*. *Leverage* means using less of your money to make the same profit. You have a choice about how much of your cash is tied up in your house. The dollar amount of the appreciation will be the same regardless of the amount you have invested, but your return can increase substantially using the principle of leverage to your benefit.

For example, consider Jim and Mary, who own a house worth \$400,000 free and clear of any mortgages or other encumbrances. Their house appreciates by 5 percent in a year, so they have earned \$20,000 or a 5 percent return on their \$400,000 investment.

Their neighbors, Tom and Sue, have a house also worth \$400,000, but they only have \$100,000 equity with a \$300,000 loan. They've invested the \$300,000 cash that they could have used to pay off their loan elsewhere, such as a diversified stock portfolio. Their house also appreciates the same 5 percent or \$20,000 in a year. But instead of the same 5 percent on their investment that Jim and Mary earned, the \$20,000 in appreciation represents a 20 percent return on Tom and Sue's \$100,000 home equity. Not only is their return better than Jim and Mary's, but also Tom and Sue are free to make other diversified investments with their large chunk of cash.

## *Protecting your investment by making it marketable*

Much of the fun of building a custom home is in creating something that is exactly what you want — it's your dream, after all! If your dream is too unique, it can pose a problem, however, if what you want is unappealing to the rest of the world. A property's value is based upon supply and demand. If many people like your home and want to buy it, then they'll bid against

each other and the price will increase. By contrast, if no one wants to own your house besides you, you may not be able to give it away. Keep these major considerations that can impact value and marketability in mind:

- ✓ **Conformity:** If the house is much smaller than the rest of the neighborhood homes, it will be less desirable. At the same time, a home that is bigger than the other homes in the same neighborhood won't attract proportionately more money.
- ✓ **Design:** People want homes that are functional and easy to maintain. A castle with a moat may be great in the French countryside, but will sit on the market forever in suburban Cincinnati.
- ✓ **Location:** Remember the real estate agent's favorite mantra: Location, location, location! Elements such as busy streets or being close to commercial buildings can deter buyers.



Your best financial security is knowing you can sell the house quickly in any market, good or bad. The more the house appeals to a large cross section of people, the more likely you can sell it at a good price in any market. Nearly any house can sell when real estate is in a boom. Ultimately, you want to be able to sell for the highest price possible when the market and the economy are at their worst because that is when you need the money the most.

## *Understanding taxes — Many parts of a home project are deductible*

One of the greatest benefits of home ownership in the United States is the benefit of tax deduction. As long as you intend to move into your custom home when it's finished — using it as your primary residence — you have a number of different items that are tax deductible:

- ✓ *Points* (loan origination fees) on the land and construction loans
- ✓ Interest on the land and construction loan
- ✓ Interest on your permanent loan
- ✓ Property taxes

The Internal Revenue Service (IRS) does limit how much money you can borrow and still deduct in interest and points. The IRS only allows deductions on a loan amount of \$1 million or less, but it does allow you to deduct the interest and points on an additional credit line of \$100,000 beyond the \$1 million.

These deductions translate into real dollar savings for you. Effectively, the government is subsidizing you to borrow money on your house, putting more money in your pocket every month. In states like California, people with substantial income can have tax savings of as much as 40 percent of their monthly payment. Here's a quick formula to calculate your tax savings:

**1. Multiply your loan amount times your interest rate to get your annual interest.**

**2. Multiply your estimated value times your local property tax rate.**

This amount is 1.25 percent in most states, but can be much more in states like Texas and New Jersey. You can get the information by calling your friendly, local county tax office.

**3. Add the interest and the taxes, and then multiply the total times your combined state and federal tax bracket.**

You can get this number from your accountant or tax preparer.

**4. Take the amount and divide by 12 to get your monthly tax savings.**

This tax savings represents real dollars you can use toward your monthly payment.

Sometimes, your deduction can be big enough to reduce your income significantly, moving you into a lower tax bracket and saving you even more money. Ask your CPA or tax preparer to check how close you are to the income thresholds.



If you claim these items as deductions during the build and then sell the home as an investment, you may have to amend your returns and pay back the savings. Check with your CPA or tax preparer about the implications and be sure of your intentions.



You don't have to wait until the end of the year to get the cash from your tax savings. You can increase the deductions on your W-9 so that you're taking home more of your paycheck on a monthly basis. Check with your CPA or tax preparer to figure out your proper withholdings and stop letting the government hold your money for free.

## *Safely Deferring Financial Decisions Until the End of the Construction Project*

Even though planning ahead is crucial to a successful custom home project, you can and need to wait until the project is finished before making certain

financial decisions. By deferring some of these choices, you can save yourself from making commitments that may strap you for cash too soon, such as applying a large down payment to your land (see Chapter 3). When you have better information at your fingertips, you can make decisions, such as locking in the rate on the permanent loan or deciding on your permanent loan amount or program. We discuss some of these choices in Chapters 15 and 16.



You have no way of knowing how much your project will actually cost or how long it will take until it's complete. Any estimate before then is strictly an educated guess. The same is true for economic conditions. You can spend a lot of time worrying about where the interest rates are or if your house is holding its value, but you can't do anything to change the situation or predict more accurately. Risk occurs either way, so you have to analyze the situations carefully.



The best approach to dealing with uncertainty is education and careful decision making. Keep emotion out of the decision process. Consult experts and educate yourself about the risks and benefits of each decision. Analyze the repercussions of delaying the decision. Ask these questions when making financial decisions:

- ✓ What is the total amount of dollars at risk on this decision?
- ✓ When will I have all the facts for sure?
- ✓ What is the worst case if I guess wrong today?
- ✓ Is there a way to protect myself against the worst case?
- ✓ What is the cost of that protection?
- ✓ Is it worth it?
- ✓ What course of action will make me sleep best at night?

## Chapter 8

# Knowledge Is Power: What You Don't Know About Construction Loans Can Hurt You

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### *In This Chapter*

- ▶ Understanding loan types
  - ▶ Finding a lender
  - ▶ Moving through the loan process
  - ▶ Figuring out fees and costs
  - ▶ Giving some burden back to the lender
- 

**T**he nation's big lenders have done a good job of teaching you to shop for a mortgage as if it were a TV dinner that you can pull from your grocery store freezer, only comparing price and forgetting taste. Getting a construction loan, however, isn't quite so simple. In fact, obtaining a construction loan is more like cooking a gourmet meal from scratch for a 20-person dinner party. Although important, the loan's total cost will end up being less important than its functionality. If you ignore details, it could be a disaster.

As you read this chapter, put aside any knowledge you may have of regular home purchase mortgages. Construction loans are different; they have different pricing and structure than loans to purchase existing homes. When you're shopping for a construction loan, relatively few loan officers have extensive experience putting one together, and even fewer firms specialize in these types of loans. Therefore, make sure you're as knowledgeable about the process as you can be before you meet with your loan officer.



Write down every detail (from program information to approval guidelines) and don't be afraid to ask questions several times until you understand everything completely. Your loan officer will probably have to research your answers and get back to you later. Never assume he understands what he is talking about unless he has personally funded at least 50 construction loans over the course of his career.

In this chapter in addition to putting construction loans in the proper perspective, we spell out the differences between construction loan types and take you through all the details. This tour includes picking a lender and understanding the different costs for construction lending.

## *Exploring Your Construction Loan Options*

If you're going to borrow money to build the house from any kind of institution, the money most likely will be in the form of a *construction loan*. This loan replaces your existing land loan. A construction loan differs from a conventional mortgage or the land loans discussed in Chapter 3 in the sense that the bank doesn't give you the money all at once. Instead the bank meters out the money based on the progress of construction. The banks have more risk because taking back a house and selling it if you stop paying them is much more difficult when the home is incomplete.



When dealing with construction lending, don't expect to find much standardization with different lenders' loan programs. Banks pretty much design their own products to fit with their own short-term cash needs. Most banks — small and large — borrow money on giant credit lines and use that money to fund construction loans. Local banks and savings and loans may use portions of their depositor base to fund loans. Because construction loans are by nature short term, banks don't need to sell the loans to third parties (a common practice for long-term mortgage loans). This short-term approach makes standard programs unnecessary in the bank's view.

That said, some similarities do exist among different lenders. All construction loans can fit in the following categories.

### *Getting it done all in one — Benefiting from a single-close*

Large institutional mortgage banks, including IndyMac Bank and Countrywide Financing, created these single-close loans during the last ten years. They figured out that people who build their own custom homes live there longer and default less often than other people. They figured (correctly) that, by offering a great construction loan upfront, they could automatically roll these customers into profitable long-term mortgages. See Chapter 15 for more info on rolling into permanent mortgages.

All-in-One, Construction/Permanent (CP), One-Time-Close (OTC), and Construction-To-Permanent (CTP) — no matter what you call it, the



single-close loan has the same features. Some features of the single-close construction loan include

- ✔ Generally, no re-qualification or re-appraisal is required for these loans. Simply finish the construction, and you get a free permanent loan with no questions asked.
- ✔ The borrower usually has a variety of popular permanent loan programs from which to choose.
- ✔ Some lenders offer options for locking interest rates before the house is finished.
- ✔ The lender may allow the borrower to buy land as part of the process provided she has all the necessary construction documentation ready before funding the loan.



As a result of the ease of the overall process, single-close loans are extremely popular and easy to find in the marketplace. These loans are excellent programs for first-time custom home consumers.

## ***Construction-only loans — The double-close process***

In this process — used by most local banks, and the only way to get a construction loan before the single-close program came along — the lending bank provides a short-term loan only for the construction time period. After construction is complete, arranging for another loan for your permanent financing is your job. Unfortunately, having to take this step means going through the process of applying and qualifying for another loan, although your bank may have you prequalify for a permanent loan before it commits to the construction loan.



We *strongly* recommend against this type of loan if you find a single-close option that works for you. Why? Because

- ✔ This process is potentially more expensive because you have to pay for two loans and all the fees and costs that go with them.
- ✔ This loan is like a short fuse on a long stick of dynamite. Many things can change in the course of 6 to 18 months while you're building your house. You have no way of knowing whether or not you or the house will still qualify for a permanent loan when the house is finished. A change in the market or interest rates could force you into foreclosure or, at best, payments you can't afford.

- ✓ The banks that sell this product work on a “buyer beware” ethic and consider permanent loan qualification or getting an unaffordable loan to be your problem at the end.

Our advice? Shop around for an all-in-one deal!

## *Full documentation versus no-income-qualifier programs*

Oddly enough, the best loan programs are available to people who can fully document sufficient income for qualification with tax returns and pay stubs. Documenting your income is always to your advantage, because you can borrow more money at cheaper rates and fees. The key? Be sure you qualify before you apply. (We go into more detail about the qualifying process in Chapter 9.) If you don't pass with flying colors, then a no-income-qualifier program is your next best option.

You may have heard the terms EZ Qualifier, Quick Qual, No Qual, No Income Qualifier, Reduced Doc, No Doc, and the like thrown about. These terms by themselves don't designate actual types of loans. They are merely the lenders' marketing terms to distinguish their own no-income-qualifier programs. And, by the way, these loans aren't necessarily easier or quicker than full-documentation loans. They usually require better credit and take just as long to approve. Here is a breakdown of the specific types of no-income-qualifier loans currently available in the marketplace:

- ✓ **Stated income, verified asset:** You must state your income and verify liquid assets that meet the lender's requirements. See Chapter 9 for more details on this particular flavor of no-income-qualifier loan.
- ✓ **Stated income, stated asset:** You can state your income and assets with no further documentation required. Stated loans are usually for people with variable income or who are self-employed.
- ✓ **No-stated income, verified asset:** You put no income on the application; however, you do provide documentation of your assets.
- ✓ **No-stated income, no-stated asset:** This loan requires great credit and costs more. You simply state your name and Social Security number.

## *Poor credit and odd-property options*

Consumers with bad credit or properties that fail to meet bank guidelines don't have many options for construction loans, much like the land loans that we discuss in Chapter 3. If your credit is below a credit score of 620 (see

Chapter 9) or if you have recent problems, such as bankruptcy, judgments, or tax liens, you don't have many options in the institutional lending world.

Additionally, any property that doesn't meet with lending guidelines as we outline in Chapters 3 and 9 (for example, property without public electricity) requires a nontraditional lending source. The best option aside from robbing a bank (no, we're not suggesting *that* as an option!) is private or *hard* money. (See "Private money — The last resort," later in this chapter.)

## *Finding a Good Construction Lender*

Picking a loan and finding the right lender can be a bit of a chicken-and-egg process. Do you find the lender and then choose the program, or do you search for the lender that has the program you're looking for? Kevin advises you to explore both directions. If you come across a great loan program, explore it further. On the other hand, if you can find an experienced loan officer with good programs, he may be worth a little more money for the service and education he provides.

Many people make the mistake of looking for someone close by and applying with the first person that makes them feel comfortable. The Internet has also become a new resource for construction financing, but most advertisers don't specialize in construction loans. They're just casting their nets wide for business. In fact, most of the links that come up on Yahoo! or Google are clearinghouses generating leads to be sold to mortgage companies. Read the ads carefully; relatively few companies actually do specialize in construction loans, and you definitely want to find an expert if you can.



Sadly, most of today's lenders are more interested in selling you their loans than helping you make the right decisions. Most loan officers are fast-talking sales guys and gals subscribing to the philosophy that the customer is always right. They'll spend most of their time telling you what you want to hear just to lock you up as a customer.

A loan officer shouldn't be a used-car salesman. He needs to be a professional expert advisor using his knowledge to advocate for your best interest. You wouldn't want your doctor or lawyer lying to you just to make you feel good, would you? Expect the same from your loan officer. Find a loan officer willing to risk your business by telling you hard unpleasant truths that will keep nasty surprises from occurring later in the process. Remember that you have lots of time and money at stake, and you don't want to lose either of those because someone was afraid to tell you the truth or acted upon ignorance. Start with a loan officer that listens to what you're saying. If he is talking about programs before asking you about your situation, then steer clear fast.

## Choosing a broker or a bank

A *mortgage broker* is an independent loan originator that helps you, the consumer, and can submit loans to many different lenders. Mortgage brokers act as middlemen and are paid primarily by the lender via wholesale pricing on loan programs, which brings up the age-old question: Do I need to eliminate the middleman? Drum roll please. And the age-old answer: It depends! You may get lucky and qualify with the right bank that has the perfect loan for you in your circumstances. It's not likely, but it could happen. The question is, if you didn't ask around and investigate, how would you know if it was the best program for you? Consider the following reasons why bypassing a mortgage broker and going directly to a bank can be limiting:

- ✔ Bank loan officers are salaried (not commissioned) and tend to be the least experienced loan officers in the business.
- ✔ Banks are product oriented. They have only their programs and, if you don't fit or don't like them, they'll send you away having wasted your valuable time.
- ✔ Banks tend to focus only on the construction loan, ignoring other ways of helping your finances.
- ✔ Any documentation you give directly to the bank must be used by the bank — even if your situation changes or can be represented more favorably.
- ✔ The bank considers depositors to be their customers. To the bank, you're just another liability. (See Chapter 16.)

Mortgage brokers today fund 65 percent of U.S. mortgages because they provide great benefits to consumers, including the following examples:

- ✔ Mortgage brokers have access to almost every loan program in the marketplace, providing a one-stop shop.
- ✔ Mortgage brokers only get paid if your loan closes, giving them incentive to get the job done.
- ✔ Mortgage brokers are required by law to disclose the fees they make, so you know exactly what they're getting paid.
- ✔ Good mortgage brokers are accustomed to comparing and contrasting many different loan programs — finding the best one for your situation, regardless of the lender.
- ✔ Mortgage brokers can act as a filter, helping to determine how to present your package in the most favorable way to the bank.
- ✔ Mortgage brokers work with you months in advance to help prepare your package.

- ✔ Good mortgage brokers may identify other loan programs for your situation, such as a refinance to help your cash position.
- ✔ Many mortgage brokers are dependent upon referral business, making them more concerned with your happiness.

Although mortgage brokers aren't necessarily less expensive than going directly to a bank, banks do offer discounts to brokers in the form of wholesale pricing, so the terms can be close. In construction lending, a broker who knows his way through the process and can get you qualified with a good program is worth far more than a bank that offers a discounted program for which you don't qualify.



Not every mortgage broker is worth your respect. Like any high-commission business, there are plenty of slimeballs. Only a seasoned professional with experience and knowledge in construction financing is going to be an asset in helping you get a good loan for your situation. (More about this topic in the next section, “Testing a loan officer’s knowledge.”) However, if you can't find anyone who meets these qualifications, first educate yourself, using this book as a guide. Then, armed with this information, pick an honest, willing mortgage broker with access to many lenders. Kevin's book *What the Banks Won't Tell You* (Grady Parsons Publishing) — available at [www.stratfordfinancial.com](http://www.stratfordfinancial.com) — has a great test for nonconstruction loan officers.

## Testing a loan officer's knowledge

Regardless of whether you work with a bank or a mortgage broker, you need to be assured that the loan officer is giving you accurate information and she knows what she's talking about. Use this book as your guide for testing your loan officer's construction loan competency. Use these five test questions for doing just that, along with references to the chapters for the answers:

- ✔ What is the difference between LTV and LTC, and how does it relate to your best programs? (See Chapter 9.)
- ✔ Why is title insurance more expensive on a construction loan? (See the section “Understanding All the Fees” in this chapter.)
- ✔ What is the difference between a *voucher system* and a *draw reimbursement system*? (See Chapter 10.)
- ✔ Calculate a nine-month *interest reserve*. (See Chapter 9.)
- ✔ Why is an *indemnification agreement* necessary? (See the section “Getting the loan after construction starts” in this chapter.)

If you're fortunate enough to be dealing with someone who understands and can articulate these issues, then you're already ahead of the game. If after you pose these problems, your loan officer is standing there with a glazed look in his eyes, run — don't walk — to a different company immediately.



Most loan officers haven't been extensively involved with construction loans. Regardless, you may find someone that has had some experience. Whether or not this person can answer all these questions exactly isn't so important. What is important is that he doesn't try and slide lies by you in hopes you don't know what he's talking about.

Find someone who tells you she doesn't know all the answers, but she can happily research the issues and get back to you. Honesty and patience are the signs of a trustworthy professional. Make sure she also asks you as many questions as possible. You can best judge your loan officer by the questions she asks rather than by the answers she gives.

## *Getting value added — Education and experience are worth the money*

A small number of mortgage brokers in the country act as construction loan consultants. Kevin's company, Stratford Financial, is one of these companies. Consulting mortgage brokers such as Stratford expertly guide you through the entire process. Their knowledge comes from seeing hundreds of scenarios in construction lending. By understanding patterns, they can almost see the future because they have seen something similar before.

They sit down with you at the very beginning of the process when you're just thinking about a custom home. They can analyze your situation as it sits today and design a program that takes into account every variable and road bump you may encounter along the path until move-in day. They then take this data — combined with your personal financials — and develop a specific plan that assures you the most cost-effective method of succeeding with all the financial steps of your project including risk management, cash flow, and lender approvals.

Sometimes the loan fees with these mortgage brokers can be a little more expensive than going directly to the lender; however, often they can find better programs and structure your project in ways that can save you significant amounts of time and money. Furthermore, you'll have peace of mind knowing you have an expert advocate on your side when embarking into uncharted waters.



If you have already made major mistakes and failed with a lender or two, find one of these consulting mortgage brokerages — construction loan consultants are accustomed to fixing these problems. After a loan runs into problems with a lender, it becomes difficult to determine where the problems are and how to fix them. If you find yourself in this position, contact the lender's wholesale office that turned you down and ask for the most knowledgeable mortgage broker in your region. You can also contact [www.customhomeexperts.com](http://www.customhomeexperts.com) or the National Association of Residential Construction Lenders at [www.narcl.org](http://www.narcl.org).

## *Private money — The last resort*

If you have realized that private or *hard* money is the only way to get the loan funded, then you still need to find the right private lender for your needs. The good news: These lenders are relatively easy to find, and they usually don't offer a lot of different options. Most local mortgage brokers or bankers can give you a referral to private money lenders. These private lenders are simply investors that like to make moderate risk interest income by making real estate loans that banks won't touch. The lender drives the process and it can be relatively easy. Your main concerns in this kind of loan are price and terms.



Hard money usually costs around 10 percent, plus 5 to 6 percentage points in fees, which is roughly twice the cost of conventional financing. The rest of the fees run the same as any other construction loan as we outline in the section, "Understanding All the Fees," later in this chapter. The terms that differ are

- ✓ The loan's time length
- ✓ How much the private lender will loan
- ✓ How the private lender gives you the money during construction

Some private money lenders are also more conservative about values with appraisals than others. Ask the referring party about its prior experience with the lender. Try to talk to two or three private or hard money lenders before you fill out an application and move forward.

## *The Loan Process from Start to Finish — When to Do What*

Because a construction process involves many people over a long period of time, you need to be as efficient as possible. Starting too early with banks can cost you money and waste your time. Waiting too long can hold up the start of your build. Remember that the actual process is all about proper timing. Use this step-by-step guide to managing the loan process.



Although exploring the construction loan process early is important in order to be prepared, you need to complete several steps before applying to a bank. By this time you should have your lot (see Chapter 3), have your finances in order (see Chapter 7), and have your plans finished and submitted to the building department.

## Deciding when to sell your existing house

For everyone who thought you'd have to sell the house you're living in before you can afford to build, we have good news. Most lenders don't calculate the cost of your current residence when evaluating your construction loan qualifications. You will, however, need to provide a letter that you intend to sell when the new house is finished. Some lenders also accept a letter of intent to rent the house. Either way, qualification won't be an issue forcing you to sell the house early. You can wait until the new house is finished, and you don't have to incur the expense of moving twice.



Because banks don't count your existing house payment during the loan application process, you can access any necessary cash you may need for your build (see Chapter 7) without affecting your qualifications. Simply refinance your existing house to the highest loan possible and take a low payment, adjustable-rate mortgage similar to the ones we explain in Chapter 16. Doing so gives you extra money for the build as well as low monthly expenses during the build. You don't need to stay on a long-term fixed payment when you're going to sell the house soon anyway.

In order to access necessary cash from their existing home, some people choose to take out a *Home Equity Line Of Credit (HELOC)* to get the extra cash out of the house. (We discuss HELOCs in Chapter 16.) A HELOC gives you access to the cash in your home; however, a HELOC does increase your current payment to cover the cash you take, whereas a complete refinance can give you the cash and actually lower your monthly payment.

If you're worried about making payments on both your house and your construction loan at the same time, don't fret. Many banks offer or require you to hold an amount of money in the construction loan called an interest reserve for covering the construction loan payments. If you have an interest reserve, you won't have to make payments on two houses at the same time. You can read more about interest reserves later in this chapter in the section "No payments — Taking an interest reserve."



Some construction lenders offer *bridge loans* to cover cash needed from your existing residence for construction. We advise you to stay away from these loans if you can. Bridge loans are more expensive than the refinance or HELOC options, and the bank secures the bridge loan with both properties instead of one. With a bridge loan in place, you have greater difficulty restructuring your financing situation if you underestimate your project and run out of money. You don't need this type of loan because the refinance and HELOC options can provide you more cash at a lesser cost.



## Applying on time

Loan documentation is only valid for 90 days from the time it is signed or initiated. This expiration applies specifically to your credit report and the property appraisal. If you apply with a bank and don't fund the loan before these documents expire, you'll be forced to pay for a new credit report as well as an appraisal extension or *recertification of value*, which is only good for another 90 days. Most lenders won't fund the loan until the permits are in place. And, because getting permits is often one of the most challenging tasks as you prepare to build your new home, applying for the permits is the best benchmark to use for your loan application. We discuss the permitting process at great length in Chapter 6.

Kevin's company, Stratford Financial, uses the permitting process to determine the correct timing for the loan application. Kevin's goal is to avoid double work, so he starts the application roughly 60 days before the borrower is ready to break ground. Because most building departments take 30 to 45 days to review working drawings, Stratford instructs clients to start loan paperwork when they turn the working drawings in for final approval.



If your permits are done and you're ready to break ground, you can apply pretty much anytime. The faster you turn in all your paperwork, and the more complete it is, the sooner you'll get funded. The loan process generally takes roughly 40 to 60 days. The slowest parts are the appraisal and underwriting processes that we describe in Chapter 9.

## Getting the loan after construction starts

Most lenders fund a loan when you're in mid-build with no problem. The only issues they may have to resolve are with the title insurance companies. Title insurance is necessary for the lender to insure that its loan is clearly secured against the property in case you default on the loan. The lender likes to be the first one to get paid back if it has to take the property back and sell it. The title insurance starts officially the day you and the bank *close escrow* (finish executing all the paperwork and transferring of money on a prescribed date) the loan and the *trust deed* (a legal paper that protects the lender's interests) securing the property is recorded with the county.

When you break ground or do any work on the property, you create what the title companies call *broken priority*. This term means that any contractor or sub who hasn't been paid as agreed can at any time file a mechanic's lien securing their debt against the property. (We talk more about mechanic's liens in Chapter 11.) The problem is that these contractors and subs can file these liens months after the loan is in place, but, because the work in question took place before the loan, the mechanic's lien takes priority and the contractor

has rights to the property before the lender. Understandably, a mechanic's lien makes the lender very unhappy and nearly impossible for the title company to insure the lender.



Most states have a remedy for mechanic's liens with something called an *indemnification agreement*. Most title companies allow you to sign an agreement assuring them that you'll pay any and all claims by contractors and subs for work completed prior to the date of recording the loan documents. The title company will want to examine your financials to make sure you can afford to take this step, but it's relatively simple and, more important, it's free!

Most loan officers don't know about indemnification agreements, so you need to educate them and check directly with the title company. Check on this issue with your loan officer and title company before anyone starts work on your property.

## Preparing the paperwork

Keeping all your paperwork handy and organized can save you time and hassle when applying for your loan. (Check out the organization tips in Chapter 2.) You need to gather personal and construction-related documents that tell the lender about you, your contractor, and your project. The following checklist describes the personal documents most lenders require before they'll review your loan package. The items are listed in the order that most lenders stack their loan documentation:

- Application (supplied by lender; lists all your personal and financial information)
- Consent form (supplied by lender; allows the lender to verify your information)
- Signed disclosures (supplied by lender; keeps the lender in compliance with the law)
- Most recent year-to-date pay stub
- Two years' W-2s
- Two years' personal tax returns
- Two years' business tax returns (if self-employed)
- Year-to-date profit and loss statement (if self-employed)
- Rental agreements (if you own rental properties)
- Three months' bank statements on all accounts, both business and personal
- Most recent statements for retirement accounts
- Closing statement (HUD-1) for land purchase

The following checklist includes the construction-related documents most lenders require before they'll review your loan package:

- Three sets of plans, including working drawings
- Completed cost breakdown (supplied by contractor)
- Completed description of materials form (supplied by contractor)
- Completed builder statement (supplied by lender)
- Construction contract (signed by contractor)
- Architect information
- Insurance agent information
- Contractor's liability policy (see Chapter 2)
- Workers' compensation policy or waiver (see Chapter 2)
- Course of construction policy (see Chapter 2)
- Copies of permits or permit applications
- Copies of paid receipts/canceled checks for items paid and work completed



Even if the lender doesn't require all these items from you upfront, prepare these items in case the lender asks for them at the last minute.

## *Locking in an interest rate*

When to lock into an interest rate is usually the No. 1 question on most home-builders' lips, but you usually have the least amount of control with it. First of all, not all construction loans have programs allowing you to *lock* the rate (fixing the rate at a certain percentage while you pursue the loan application process). The programs that do allow you to lock the rate generally lock at higher than the market rate you would get on a refinance loan on the same day. Why? Because banks can't predict what the interest rates are going to be 6 to 18 months down the road when you finish the house, anymore than you can. And being banks, they're certainly not going to accept additional risks that they can successfully pass on to you. Some banks offer lock options if you pay more in the interest rate or pay upfront fees. Much of the decision whether or not you can lock the rate depends upon on your qualifying program.



When you lock, you're betting that the market will get worse during your build time. But how can you decide whether or not that will be the case? First, analyze the economy by reading all the financial reports on [www.yahoo.com](http://www.yahoo.com) and in the *Wall Street Journal*. If you're still sane, have your loan officer lay out the lock options on the programs for which you qualify. Figure out the dollars side

by side and make your best guesstimate. Understand taking any lock before you're approved may be a total waste of time if the bank turns you down or you pick the wrong program.

## *Determining the length of your construction loan*

Most construction loans are offered for a period of 12 months. Some lenders offer shorter periods or longer, but rarely are they offered for less than 6 months or more than 18 months. But if you want something different than the standard 12-month loan term, you're going to pay a different rate. The 6-month rate is usually lower than the 9-month rate, which is lower than the 12-month rate, and so forth.



Be conservative rather than optimistic in estimating your timing. Despite your carefully constructed building plans, you really don't know exactly how long it's going to take to finish building your custom home. You may save a little money upfront with a shorter loan — thinking your house will be done sooner rather than later — but you could have to pay expensive penalties for going over your time limit when schedule delays interfere with your best-laid plans. Choosing a 9-month period over a 12-month period may save you only .125 percent or \$625 on a \$500,000 loan amount, but the penalties on this same loan for going past the 9-month term could be as much as .5 percent of the loan amount, or \$2,500 each month until you finish. Ouch! Not only that, but you also have to pay the penalties in addition to the interest you're already paying, which can get very expensive indeed.

## *Understanding All the Fees*

So you've probably been wondering what all this financing is going to cost. There is nothing like the irony of the loan officer handing you that piece of paper with the big number that makes you feel there should be a brand-new car in your driveway. Who are all these people and why do they need to be paid so much money? In this section we break your loan down, fee by fee, so you can justify where your money is going. Be aware that construction loans have their own, unique quirks.



Your best guide to your fees will be the original Good Faith Estimate (GFE) completed by your loan officer at the time of the original application. If you're lucky, your loan officer will fill it out by hand right there on the spot so you have it in her handwriting with a copy you can go back to later. See Figure 8-1 for a sample GFE. If the government form the lender uses isn't clear to you, ask your loan officer to write the fees on a simple piece of paper. Make sure your loan officer explains every fee clearly and consistently.



STRATFORD FINANCIAL SERVICES

www.constructionloanexpert.com

Borrower: Smith

**GOOD FAITH ESTIMATE**

This list gives you an estimate of most of the charges due at the settlement of your loan. The figures are subject to change. They are based on a value or sales price or total build of \$ 870,000 and the proposed mortgage amount of \$ 650,000. For an explanation of these costs, please refer to the 'Settlement Costs and You' booklet.

LOAN TERMS Construction to Permanent, Stated Income, owner-occupied, 30 yr fixed, 12 month build, no prepayment penalty

Starting Payment \$ 4544.89 est. P.I.T.I. \$ 5640.72 Interest rate 7.5 % est.

801. Loan Origination Fee <u>1.5</u> pts. + \$ <u>0</u>	=	\$ <u>9750</u>
1303. Funding Fee		\$ <u>350</u>
1306. Loan Document Fee		\$ <u>350</u>
813. Tax Service Contract		\$ <u>65</u>
812. Life-of Loan Flood Contract		\$ <u>15</u>
815. Courier Fees		\$ <u>50</u>
803. Appraisal Fee		\$ <u>750</u>
804. Credit Report Fee (personal)		\$ <u>50</u>
804. Credit Report Fee (business-for self-employed)		\$ _____
814. Processing Fee		\$ <u>450</u>
902. Mortgage Insurance Premium (1st year)		\$ _____
1101. Settlement Fee (escrow or attorney fee)		\$ <u>1000</u>
1108. Title Insurance Premium <u>Includes Endorsements</u>		\$ <u>3000</u>
1201. Recording Fees		\$ <u>100</u>
815. Misc. <u>Administration + Inspections</u>		\$ <u>750</u>
<b>TOTAL ESTIMATED NON-RECURRING CHARGES</b>		\$ <u>16680</u>

The following items are not fees, but may either be collected or retained at the close of escrow.

901. Prepaid interest \$ _____ per day @ _____ % (30 days)	\$ _____
1303. Interest <u>Reserves (12 months)</u>	\$ <u>29250</u>
903./1001. Insurance <u>Course of Construction</u>	\$ <u>2000</u>
107./1004. Property Taxes _____	\$ _____
1002. Mortgage Insurance Premium (2 months)	\$ _____
905. Misc. _____	\$ _____
<b>TOTAL EST. RECURRING CHARGES AND/OR RETENTIONS</b>	\$ <u>31250</u>
<b>TOTAL ESTIMATED CHARGES</b>	\$ <u>47,930</u>

**ESTIMATED CASH REQUIRED TO CLOSE**

\$ 0

Date \_\_\_\_\_

Borrower \_\_\_\_\_

Co-Borrower \_\_\_\_\_

**Figure 8-1:**  
Good Faith  
Estimate.

## Paying points

There is no shortage of loan people trying to make their point. (It's okay to groan on that one.) *Points* are upfront fees (one point is equal to 1 percent of the loan amount) charged for one of two reasons:

- ✓ To generate cash at the closing to pay loan officers and origination departments
- ✓ To reduce the interest rate by compensating upfront for the interest the banks pay to their investors



Despite what the TV loan hucksters say, points aren't inherently evil or good, they just simply are. Paying more points can be advantageous if the points create a comparable savings. You and your loan officer need to figure out what is the best deal for your situation. Points are usually broken up into eighth fractions. Check out the following list to see how they're represented. This list can help you with discussions with loan officers on points and rates:

- ✓  $\frac{1}{8}$  = .125
- ✓  $\frac{1}{4}$  = .250
- ✓  $\frac{3}{8}$  = .375
- ✓  $\frac{1}{2}$  = .500
- ✓  $\frac{5}{8}$  = .625
- ✓  $\frac{3}{4}$  = .750
- ✓  $\frac{7}{8}$  = .875
- ✓ 1 = 1.000

Even though points have some flexibility, you won't find many construction loans out there at zero points. Depending upon the terms of the program and how much risk the bank takes, your points should range between 0 and 3 for a conventional lender. Hard money is more expensive. For zero points to happen, the lender has to increase the interest rates in order to pay a *rebate* to the originating broker or loan officer. This scenario may or may not work to your advantage.



To figure out whether you're getting a better deal on points versus rate when comparing two loans, follow these steps:

1. Calculate the loan amount times the points on each loan.
2. Multiply the loan amounts by .6 to represent the amount of loan you'll use during construction.
3. Multiply this amount by the offered interest rate.

4. Add the points and the interest together.
5. The loan with the lower total is the better deal.

Most knowledgeable mortgage brokers want to make at least 1.5 to 2 points on a construction loan because it's much more work than a purchase or refinance. Loan officers split the fees with their company so they don't always get the lion's share of the points being charged. Some mortgage brokers who provide consulting services or solve difficult problems may charge more.



You can negotiate points, especially with mortgage brokers, but make sure you negotiate upfront. Waiting until the mortgage broker has done all his work and then beating him up on fees at the last minute is unethical, particularly if he is charging what he disclosed to you at the beginning. If he didn't deliver what he promised, then negotiating may be okay. Also, by negotiating in a hardball fashion at the end of the process, the broker may simply decide to not fund your loan, leaving you suddenly high and dry. Remember that a good loan officer is worth his weight in gold throughout the entire project to help work with the lender.

If you're concerned about being overcharged, negotiate upfront the amount of points the mortgage broker will charge, allowing for extra work such as problem solving and exceptions. Most mortgage brokers appreciate this upfront approach and accommodate you. And because mortgage brokers must disclose their fees by law, you can insure they're making good on their part of the deal. Imagine how great it would be if other professionals like attorneys and mechanics were willing to agree on costs upfront. Yes, we know *that's* not going to happen, but we can dream, can't we?



Points are generally tax deductible on your primary and secondary residence. As long as the loan amount is less than \$1 million, you may be in for some extra savings. Check with your accountant or tax preparer to make sure you're taking advantage of all the tax benefits available with this project. Don't you think it's about time the government started paying you instead of the other way around?

## ***Escrow and title are more than other loans***

Clients who look at the GFE often notice significant differences between the rates charged for escrow and title by various lenders. Being able to identify this difference is actually a great tool for weeding out loan officers who aren't really that informed about construction loans. The Real Estate and Settlement Procedures Act (RESPA) heavily regulates title fees, so they're pretty much the same no matter which company you use. The title fees are more expensive, however, than the same fees for a purchase or refinance loan. Escrow companies and escrow attorneys often charge more for construction loans because of the additional risk they assume for construction loans and the added work that is involved.



The reason for the added expense in the title insurance has to do with mechanic's liens (see Chapter 11). These liens are remedies for contractors and subcontractors to recoup money if you don't pay them, and they can attach (file a legal claim against) the property. The title company's job is to protect the lender from this happening, otherwise, the lender won't loan you money. The title company accomplishes this by way of an *endorsement*. Various endorsements are required throughout the project every time you take money from the bank. The price of these endorsements can range from one hundred to several hundred dollars. So, although title insurance (including endorsements) for a \$500,000 refinance may cost only \$1,200, title insurance for a construction loan (including endorsements) may cost as much as \$3,000.



If you're working with a loan officer who is well versed in construction loans (exactly the kind of person we advise you seek out), accept the title and escrow company she recommends. You may already work with your own attorney or escrow officer, but chances are that he isn't familiar with the construction lending process. If he stumbles or makes a mistake, *you* will suffer. Using someone else's title company on a construction loan can end up adding two weeks to the process.

## *My goodness . . . so many appraisal fees*

Construction loan appraisals are different than appraisals obtained for a purchase loan or a refinance. For construction loan appraisals, the appraiser has to work from the plans and specifications to assess what the house will be worth when it's finished — a feat much more difficult than assessing a house that is already built. And because custom homes often congregate in neighborhoods of other custom homes, comparable properties against which to compare home values are hard to find. Needless to say, these appraisals take more time and cost roughly 25 percent more than conventional appraisals. The price of an appraisal can range from \$350 for small houses in a modest price range, to \$2,000 for mansions in multimillion-dollar neighborhoods. If you have a large loan amount — say, more than \$650,000 — you can double the cost of the appraisal fees because the lender will probably require two appraisals.

In addition, many lenders review the appraisal because it's their most critical piece of information as we describe in Chapter 9. They may just have it *desk-reviewed*, meaning a reviewer checks all the information stated by the appraiser with his or her own research online. This desk-review generally doesn't cost you any money. The lender may, however, request a field review where the lender has another appraiser go out to the property and state an opinion. This extra appraisal may cost you an additional \$150.





Don't order your appraisal too early in the process; your appraisal is only good for 90 days. Although an appraisal can be extended with a recertification of value for an additional 90 days, depending upon the lender's guidelines, this extension can cost you another \$150 to \$250 depending on whether the appraiser needs to add recent comparable properties to bring it up-to-date. And don't order the appraisal yourself. After you select a lender or broker, have him do it. The appraisal has to be in your lender's name anyway, so if you change lenders, you'll need a *retype* at a cost of \$150 — assuming that the appraiser gives you the retype at all. Appraisers tend to be loyal to their lenders, so they make up all sorts of excuses as to why they can't release the appraisal to you even though you paid for it. A threat of legal action usually solves this problem, but paying for a new appraisal is much cheaper than litigation.

## Insurance costs



Don't forget to consider the cost of insurance in your construction loan; we cover the various kinds of insurance necessary in Chapter 2. Assuming you aren't acting as your own contractor, you'll have one insurance policy to pay for at the close of escrow — the *course of construction* policy. This insurance policy pays for any damage that occurs to your property during the course of the build, and it must be in place before the lender will fund the loan (the lender protects its investment in the property, as well as your own!). Your insurance agent needs to start shopping for the best policy for your situation early in the process. The price of the policy is based upon the loan amount, and roughly runs \$1,500 to \$3,500.

## Figuring all the little stuff

Various parties charge their small fees in the construction loan. These fees are often referred to as *garbage or junk fees*. But, junk or not, they can add up, and they deserve your attention. Some of these fees may be negotiable, but most aren't. Don't let that stop you from asking.



So, what do these fees pay for? Most are for items necessary to cover real costs that occur on the loan. Because consumers have become so points- and fee-sensitive, lenders have felt hard pressed to break the loan fees out into every service they have to pay. The following list details most of the small fees that routinely occur in a construction loan:

- ✓ **Administration and inspection fee:** We extensively discuss the purpose of this fee in Chapter 10. This fee covers the costs of inspections and wire transfers every time you take money during the construction loan. It may be collected along the way rather than upfront, but if taken at the beginning, the fee is usually \$700 to \$1,000.

- ✔ **Credit report:** Each lender that is considering loaning you money has to order your credit report from a credit reporting agency such as Experian. These fees have decreased recently, and are usually less than \$50 for all three bureau reports.
- ✔ **Documents:** The lenders subscribe to document software services that prepare the loan documents for signing. Often they pass on the \$175 cost to you.
- ✔ **Flood certification:** The lender needs to know if your property is in a flood zone to make sure it doesn't require special flood insurance. This fee is a cheap one at \$15.
- ✔ **Funding and underwriting:** Lenders actually give these terms a variety of different names; they charge \$400 to \$750 in junk fees because they can (and they do). The fees generally represent administrative fees within the lender's particular branch. In his 21+ years in the business, Kevin has never successfully argued them away, so don't feel bad if you can't either.
- ✔ **Messenger fees:** A whole bunch of paper shuffles from the broker to the lender, from the lender to escrow, from escrow back to the lender, and much more. Sometimes documents can be e-mailed, but the lending industry does a good job of keeping messengers and UPS very busy. Figure \$50 to \$100.
- ✔ **Processing:** Mortgage brokers charge this fee to cover their administrative costs because most of the points go to loan officer commissions. Many mortgage brokers use them as processor incentives to improve service to the customer. Figure \$350 to \$500.
- ✔ **Recording:** A number of documents have to be recorded with the county, including the trust deed securing the property, as well as the construction loan agreement. This costs roughly \$100.
- ✔ **Tax service:** The lender needs to know that you're paying your property taxes on time to ensure that the property doesn't get *attached* (legally taken) and sold at auction by the government. Independent companies provide this service for \$65.
- ✔ **Wire transfer:** The lender generally wires funds to the title company at closing. Expect to pay roughly \$25 using the federal wire transfer system.

## *Letting the Lender Carry Your Burden*

In his many years (and more than 800 successful projects) in the lending industry, Kevin has discovered some philosophies for using construction loan offerings that can benefit you in the long run. The following sections explain it more in-depth.

## *If someone offers you money, take it*

Always apply for the highest loan you can qualify for. Ultimately, you don't know what this project will cost until it's finished. As we explain in Chapter 20, nothing is worse than running out of money in the middle of the project. In addition, you may have some last-minute surprises before the loan gets started that require more money. You can usually cover these surprises with a higher loan, but only if you have structured your loan to qualify for that higher amount.

You may be the smartest construction estimator on the planet and think you're being smart saving two points by borrowing \$100,000 less than the bank offers. Chances are, something unexpected will occur and saving that \$2,000 will cost you \$20,000 while your project sits because you ran out of money, or it will cost you an additional \$15,000 to get a new construction loan — assuming you can find another lender that will accept your project.



There are benefits to borrowing more money than you think you need. Taking a higher loan can reduce the amount of cash you have to put in the project at the beginning. (See Chapter 9 for more details.) You don't have to use all the money from the loan if you don't need to, and you can roll to a lower loan amount as we explain in Chapter 15. Consider the extra points a tax-deductible, low-cost insurance policy for your new home.

## *No payments — Taking an interest reserve*

Some, but not all, construction lenders offer you the option of having an interest reserve. (We explain how to calculate this reserve in Chapter 9.) An *interest reserve* is a portion of the construction loan funds that are set aside for making payments on the construction loan during the build. Every month, the lender calculates how much money you have requested, multiplying this number by the interest rate and dividing it by 12 to come up with the amount of interest due for the month. If you have an interest reserve, the lender simply adds the amount to your loan balance. If you don't have an interest reserve, you need to make this payment out of pocket.



Some lenders require the reserve, but for those that don't, here are three reasons why the interest reserve is a good choice:

- ✓ **One less thing to worry about.** You'll be managing the project, your job, and your family, and everything will be in transition. An interest reserve gives you one less bill to keep track of and one less check to write. If you miss a payment, it could be disaster for your credit.
- ✓ **It can increase your loan amount.** Lenders only provide a loan for items covered in your budget, which we explain thoroughly in Chapter 9. The interest reserve is a line item that the lender will happily accept.

- ✔ **It helps your cash flow.** You're going to make payments on the house you live in during the build. Without the interest reserve, you have to make two house payments along with any other money you have to spend during construction.

Interest reserves are only offered as a part of a construction loan. If your lender doesn't require an interest reserve, ask it if an interest reserve is an option. If your lender doesn't require or offer an interest reserve, you can always take the same amount of money from your savings and set it aside to be used for payments.

## Chapter 9

# Qualifying: It's the Bank's Way or the Highway

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### *In This Chapter*

- ▶ Deciphering how construction lenders make decisions
  - ▶ Uncovering your bank's rules and guidelines
  - ▶ Understanding how a construction loan works
  - ▶ Creating a budget for financing
  - ▶ Figuring out other budget problems
- 

**I**f you're paying cash out of your pocket for your new home, then most of the information in this chapter isn't necessary. But, because only a very small number of custom home projects are completely self-funded, you probably need a lender's help to turn your new home into reality. If you're like most borrowers, you'll probably begin with a local bank or national lender. Throughout this process, your bank will remind you of its own version of the Golden Rule: Them that has the gold makes the rules!

Usually, that rule works out just fine, except, most of the time, your lender doesn't tell you what the rules are until after you've broken them, which is why we include this chapter. Although every lender has its own unique take on the rules, a number of elements are common that you need to familiarize yourself with before beginning the loan process.

In this chapter we explain how banks make decisions on construction loans. We give you a look at bank guidelines for approving construction loans, and we provide you with the math formulas banks use to calculate construction budgets. Finally, we address issues that can come up in the bank approval process — and there are more than a few!

## *Stepping Behind the Desk — How a Construction Lender Views Your Project*

When you apply for a construction loan, the bank doesn't consider you to be a customer in spite of the friendly smile on the loan officer's face. What? How can that be? Actually, the bank's customers are the people who give it money to invest. Banks make their profit by loaning money at higher rates than they pay to investors with as little risk as possible. You're a necessary "evil" involved in making that profit. The money comes automatically when you make your payment, so the entire process for giving you a loan is centered around making sure you and the project are a safe investment.

In this section we give you the banks' perspective on risk and their approach to business. We also explain their approach to your intent for the property.

### *Why some lenders may seem uncaring*

Gone are the days when banks made decisions based upon relationships or their personal knowledge of the borrower. Today, government regulators and statistics control most of the policies and procedures in banking. The result is that fewer institutions are loaning their own money for mortgages; Wall Street actually backs most loans in some fashion, even construction loans. The pooling and selling of money to Wall Street — combined with the savings and loan debacle of the late '80s — has created a much more regimented system for *underwriting*, a term that means assessing the overall level of risk on a particular loan.

Although today's electronic underwriting may seem like a less personal approach, it has allowed the underwriters to be a bit more consumer friendly. The underwriting is now less arbitrary. With the computer modeling taking most of the heat for denials or conditional approvals, the underwriter can be more of a consumer advocate focused on getting as many loans that fit through the system. Essentially, the underwriter can play the good cop while the computer plays the bad cop. (Refer to the "Man versus machine" sidebar in this chapter for more information on the underwriting computer system.)



Our recommendation is to not take the underwriting process personally. In one case Kevin was asking his friend — president of a large bank — for an exception on a loan, and the response was "Gee Kev, I would love to. Please give me a reason I can give to the bank regulators when I get audited, other than just doing a favor for a longtime friend." At that point, Kevin understood that today's loan decisions go way beyond the local scene. Fortunately, with aggressive production bonuses in place, most lending employees want your loan to fit their guidelines as much as you do. The more you design your loan to fit the rules, the smoother the process will go.

## Man versus machine

For years, underwriting was considered an art and not a science, but today, science and technology are quickly catching up. Since the turn of the century, most loans go through an electronic underwriting system before being passed over to a human being. These risk-assessment systems take into account data from the performance of thousands of loans over past decades. Based upon credit scores and asset and income information, computer programs

determine the likelihood of default on your part. The computer program may raise the interest rate accordingly or suggest denial altogether. In Big Brother fashion, human underwriters are rarely allowed to override the computer decision. The human underwriter's job instead is to verify the accuracy of the input information and review documents that are more visual in nature, such as appraisals and tax returns.

## *Understanding risk assessment*

So, what's the risk? You know you're going to make your payments, right? Actually, so does the lender. The number of consumers that default on their home loans is less than 1 percent according to the Mortgage Bankers Association. In most of those cases, the bank takes back the property to recoup its loss. Banks, however, aren't in the real-estate sales business and they don't want to be. Even late payments affect their process of making money on your loan. The underwriting criteria is designed to weed out the people who have a higher probability of paying late or not paying at all.

The other assessment being analyzed on your file is the ability to sell the loan to investors. Most loans are eventually sold to Wall Street investors that have set specific criteria for loans to buy. If these loans go into default, then the original lender may be forced to repurchase the loan from the investor. Repurchasing a bad loan uses cash that the bank could have used to lend to someone else. And if the sale of a recovered property takes a while for the bank, a default can get very expensive indeed.

## *How banks view your property*

Your property is the major security for the loan that the banks guarantee against default. How much the property is worth in the banks' eyes comes down to marketability or the ability to resell your property if the bank has to take the property back in a *foreclosure*. Banks love properties that are vanilla. For example, the more the house is like every other house in the neighborhood, the happier the banks are. Banks love suburbia. A house resembling all others in the neighborhood may of course be the exact opposite of the adobe

igloo with the moat and castlelike turrets on the 120-acre estate you have dreamed about since childhood. And there lies the problem for custom home borrowers.



Ultimately, the lender wants the same thing as you. The lender wants to be able to sell the house fast for the highest price in the worst of economic markets. In order for that scenario to happen, the lender requires a property that has the broadest possible interest to potential buyers. The more unique (or odd) the house is, the more the house requires a buyer with unique taste, someone who is relatively rare compared to the vast majority of home buyers. Fewer buyers mean a longer selling time and lower resale. Lenders have years of data that tell them what houses sell fast and what issues can leave a property desperately waiting for a buyer. Ultimately, the security of the money you invest in your property will be better protected by approaching your design and considering the lender's point of view. You can read more about the design process in Chapter 5.

## *How lenders view contractors*

Lenders have loosened their requirements for contractors considerably over the last few years. They used to require full financial review, including tax returns, bank statements, and a first-born child or two. Some lenders still have a rigorous approval process for contractors because of their concerns about a contractor's financial ability to manage the project's funds. However, because most banks have adopted the draw reimbursement system we describe in Chapter 10, banks are at less risk now that money only gets paid after the work is done.



Most banks simply want to see that the contractor isn't a deadbeat and that he has solid experience building houses, indicating that the home will be finished in a workmanlike manner. Banks also like to see that the contractor's license and insurance (liability, workers' compensation, and so forth) are in order. (See our discussion in Chapter 2 for more information on insurance.) Although the bank provides some level of scrutiny for picking a contractor, you'll want to dig deeper as we discuss in Chapter 2.

## *How lenders view occupancy*

Did you ever imagine that your lender would care who was planning to live in your new home? Well, your lender does care — and your answer has a major impact on your loan. If *you*, the borrower, are going to live in the house, then the house is considered to be *owner occupied*. This type of occupancy earns you the very best rates and the most flexible underwriting terms. Why? Because people rarely walk away from the home they live in, so the lender has relatively little risk that you'll default on your loan.



If you're planning to use the home as a vacation house, then it's referred to as a *second home*. The lender looks to make sure that the house is in a likely vacation area or resort town and not next door or across town. This loan may have terms that are slightly less favorable than owner-occupied homes, but second homes add minimal risk statistically, and you can usually find a variety of good loan programs available.

If you intend, however, to sell your home immediately after it is built, then the lender will consider it as a *speculative* or *spec home*. Even if you plan to rent it or use it as an investment, the lender still calls it *nonowner occupied* and treats it as a spec home. Most conventional lenders don't offer consumers construction loans for spec or nonowner-occupied homes because of the added risk of default. These homes require commercial funding that we outline in the next section, "How lenders view spec projects."



TIP

If you aren't sure what you're going to do with the house after it's completed, you can finance it intending to owner occupy and defer the decision to sell until later. To meet the terms required by most lenders, you must agree to occupy the property within 30 days of the home's completion. But few loan agreements specify exactly what occupancy means, or even how long the occupancy must be. Lenders do become suspicious, however, if the property is listed for sale before the loan has been converted to permanent financing. Most construction lenders take a dim view of someone who uses this approach more than once.



WARNING!

If the lender suspects that you're building a property for speculation on an owner-occupied program, your loan may be turned down or, at the very least, you may be hit with a *prepayment penalty* (a fee charged if you sell the house or refinance it within a specified period, usually three years). On a \$600,000 house, this penalty could amount to as much as \$25,000! In addition, if the lender makes you the loan as owner occupied, and you put the house on the market before it is finished — or, worse, default — your lender can require the note to be paid off in full immediately and sue you for fraud, depending upon state laws. Take our word for it; fraud is one path down which you don't want to walk!

## *How lenders view spec projects*

If you're definitely planning to sell your home immediately after it's built and not occupy it yourself, then you need spec financing. Spec financing comes in two forms: well-qualified and unqualified.

Well-qualified people have

- ✓ Excellent credit
- ✓ Income that is three times the amount of their monthly expenses

- ✓ Liquid assets equal to roughly  $\frac{1}{2}$  the amount they're intending to borrow
- ✓ A track record of building and selling houses successfully

If you meet these criteria, then you can walk into almost any bank and get a spec loan for your house and begin a strong banking relationship. The loan will probably be at an interest rate of roughly prime plus 1 percent, and the lender will charge you 1 percent of the loan amount in loan fees called *points*. (See Chapter 8 for more information on points.) The lender loans you roughly 75 percent of the value of the finished property as long as you have put in a good chunk of cash as a down payment.

For individuals who don't meet these requirements — that is, unqualified borrowers — private money is the likely path, because banks are unlikely to provide spec financing to this category of borrower. (We discuss private or hard-money financing further in Chapter 3.)

## *Recognizing What a Construction Lender Really Wants to See*

Underwriters are looking for reasons to turn a loan down, not for ways to make sure you qualify. They are given exact “deal killer” rules that can't be broken under any circumstance, and they do check first to make sure that the borrower's package meets all these rules. Rules can include such absolute requirements as:

- ✓ Borrowers must have a credit score of 620 or above.
- ✓ The loan-to-value ratio must be 80 percent or below.
- ✓ The property can't be *off the grid* (not connected to a conventional electricity utility).

If the borrower passes this first test, then the underwriters look at guidelines that may be a bit more gray in nature. Guidelines can include such flexible requirements as:

- ✓ The borrower's debt-to-income ratio must be less than 42 percent.
- ✓ The borrower needs to have an average bank balance of, say, \$5,000.
- ✓ The borrower needs to have some previous experience in building a custom home.

Unlike the case of rules, underwriters have some discretion where guidelines are concerned. They can examine the file to see if it fits both rules and guidelines in all areas — credit, income, assets, and the construction project — and then make a decision to either approve or deny the loan, based on their best judgment.



With any given lender, you only have one chance to show off your stuff. If your information doesn't fit a lender's rules and guidelines, you can't usually go back and resubmit your loan application with different information unless you can document reasonable and specific reasons for the change. Submitting your package through many different brokers can also cause problems. If two loan applications from two different brokers are submitted with contradictory information, the lender will be forced to turn down both applications.



We recommend that you find a knowledgeable, honest broker who will openly communicate information about your application. She can prescreen your file and suggest ways to meet the lender's guidelines in an ethical manner. Stick with that loan officer and make her earn her money. Do keep in mind, however, that what may be a hard rule for one lender, may be a flexible guideline for another. A good mortgage broker knows these differences and can submit your loan package accordingly, which is even more reason to be very careful when you decide which broker to cast your lot with. We talk more about mortgage brokers in Chapter 8.

## *On your credit report*

Most lenders use credit scoring for underwriting. They use the three major bureaus in the United States that report credit: Experian, TransUnion, and Equifax. These companies all use a computer modeling system to assess your credit and predict how you'll perform on your loan.



The Fair Isaacs Company created the system for Experian, and your credit score is commonly referred to as a FICO score (the other bureaus have their own brand names for credit scores, including Beacon and Empirica).

The underwriter looks at the scores reported by the three bureaus for both you and your spouse. She then determines the middle score of the three for each of you and uses the lower of the two scores. Scores fall into the following categories:

- ✓ **Excellent (720+):** This score qualifies you for just about any program offered today.
- ✓ **Good (680–719):** With a few exceptions, most programs from most lenders can be had with this score, including no-income-qualifier (NIQ) loans that we address in Chapter 8.

- ✔ **Fair (620–679):** This score limits your choice of lenders and programs. Many NIQ programs require scores higher than 680 or 640 for full documentation. A couple of lenders do consider scores down to 620 for both, including IndyMac and First Horizon Bank.
- ✔ **Subprime (619 or less):** This category is sometimes referred to as B-paper. Almost no institutional lenders write construction loans for people with this credit score.

Credit scores are heavily impacted by three issues in order of importance:

- ✔ **Derogatory (bad) credit:** Late mortgage payments within the last 12 months do the most damage, with late payments on car or student loans also doing major damage. Late payments on *revolving debt* (credit cards or store accounts) may not be deal killers, but collection accounts, tax liens, bankruptcies, and foreclosures do affect you if they're recent. If you have these problems, consult with your loan officer before paying off anything. If you try to fix the wrong thing at the wrong time, you can cause your score to drop even more.
- ✔ **Credit card balances:** The best scores go to individuals who use credit wisely, and who keep their credit card balances under control. Ideally, you need to have a fair amount of credit available with the balances equaling about 35 percent of the available credit limits. Maxing out your cards can drop your scores 20 to 50 points, so try and avoid those half-yearly Nordstrom sales (or at least be sure to pay back your credit card quickly!).
- ✔ **Inquiries:** Whenever you apply for credit — for a car loan, a credit card, or even to rent an apartment — your prospective lender makes an inquiry to check your credit report. This inquiry has an impact on your credit scores. The more inquiries you have, the more you smell like someone in financial trouble to the computers. Keep your new credit inquiries to a minimum. You can shop an unlimited number of mortgage companies within a 30-day period, but you always need to know who is looking at your credit. After you know your scores, you can tell anyone who needs to know without running it again. Beware of Internet credit-checking services because they also generate unwanted inquiries.



Fortunately, even if you have less than stellar credit scores, you can improve them — often, in a matter of days. The following list describes the best ways to repair your credit if you've broken it somewhere along the way:

- ✔ **For derogatories:** If your credit report contains some incorrect information, get a letter saying so from the reporting company. Sometimes, you can call a company and plead for a letter; just don't bother pleading through the regular customer service number — they have heard it all

before. Call the CEO's office. You won't get the CEO, but you may get a letter from a sympathetic vice president if you paint the right sob story and appeal to his humanity. Getting mad doesn't work, but crying can be very effective (we're not joking here!). Always make sure the letter is on the company letterhead, references the account number, and says the account was paid as agreed.

- ✔ **For balances:** Only two of the three major credit bureaus change their scores if you pay down the balances, but that's okay because you only need to boost two scores to increase the middle one. If you're in a hurry, make an electronic payment by phone or Internet. Next, call customer service for the creditor that you just sent the payment to and have a representative fax you a letter on company letterhead referencing the account number and stating the new balance.

If these methods don't work for you, or if your issues relate to inquiries, tax liens, bankruptcies, foreclosures, and the like, have no fear. Time is always on your side. The credit bureaus sweep their records every 90 days or so, and *everything* negative drops off your report in seven to ten years. You may think that length of time seems like a long time, but it beats *forever!* More good news: Most issues older than two years — even foreclosures and bankruptcies — have minimum impact on your credit score, especially if you have re-established a solid record of on-time payments and kept the level of your overall debt under control. Talk to your loan officer about ways that you can raise your scores and the necessary time frame.

## *On your tax returns*

Income is important to construction lenders, but less so when your credit is good and the proposed loan amount is a low percentage of the property value. Full-documentation loans still get the best rates and terms, but not by much. No-income qualifier loans (see Chapter 8) provide a simple alternative when full documentation is too cumbersome, or won't support the income necessary for qualification. Not every lender looks at full documentation the same, but at least most lenders look for some standards when calculating your gross monthly income (GMI):

- ✔ **Salaried:** Lenders look at two years' W-2s and tax returns accompanied by the most recent pay stub. Lenders want stable employment for two years and give full value to the current salary. Bonuses and overtime are averaged over 24 months.
- ✔ **Commissioned:** People with variable income have to provide their most recent two years' tax returns. Their income is averaged, and business expenses listed on the tax returns are deducted from income. Lenders want to see consistent or increasing income.

- ✔ **Self-employed:** Anyone who owns 25+ percent of a company is considered self-employed. The lender asks for two years' personal and business tax returns, as well as a year-to-date profit and loss statement (YTD P&L). The lender adds all three totals together, as well as any depreciation. The total is divided by 24 plus the months covered in the P&L and added to personal income.
- ✔ **Other income:** Nothing gets missed by lenders; they look at any other income or losses you have from rental properties, investments, partnerships, and other sources. Two years' averages are used, and your income will be adjusted by the profits or losses.

Construction lenders want to make sure you have enough income to make timely payments for your new home, as well as any other payments you have to make, such as for cars and student loans. To figure this amount, they use debt-to-income (DTI) ratios. Two ratios are represented, but only the second ratio — the *back-end ratio* — really matters. This ratio tells the bank what percentage of your income will be needed to cover PITI (principal, interest, taxes, and insurance), as well as all your other monthly credit payments. Here are the steps to calculating the back-end ratio:

**1. You need to know the loan payment.**

Estimate a loan amount (you have to start somewhere) and find out the current interest rates from your loan officer. Have your loan officer calculate the principal and interest payment, or you can use one of the many Internet calculators like [www.mortgage-calc.com](http://www.mortgage-calc.com).

**2. Calculate the property taxes.**

Take the house's projected future value and multiply it by 1.25 percent. This amount is the annual tax rate in most areas; you may need to adjust it slightly in your own neighborhood. Divide this number by 12 to get the monthly amount.

**3. Calculate the insurance.**

Take the loan amount and multiply it by 0.35 percent. (Lenders use this number as an estimate.) Divide by 12 for the monthly amount. Add the amounts from the first three steps to get your PITI.

**4. Add in any installment payments that still have ten months or more to go, such as car and student loans, as well as minimum payments on your credit cards.**

If you have your own business that pays for these items, they don't figure into the ratio.

**5. Take the total and divide by your gross monthly income.**

If the number is bigger than 0.45, you probably need to consider a no-income qualifier loan of some kind.



This step-by-step version is a simplified, back-of-the-envelope description of debt-to-income assessment, and many more variables can affect it, depending on the complexity of your income and investments. If you're at all unsure of where you stand, meet with an experienced loan officer and walk through the information until you both understand it. By doing so you can avoid surprises when the loan is underwritten.

## *In your bank accounts*

When it comes to your bank accounts, you need cash, cash, and more cash! (You can also take a closer look at Chapter 7 to discover how important cash is.) Banks know that the surest way to protect a construction project from utter disaster is a big pile of readily available money, which means cash in your bank account. Note the following areas of concern related to underwriting for cash:

- ✔ **Cash in the project:** The bank evaluates all other cash requirements after it accounts for any money needed for the project. The section “Calculating the Loan Amount and Cash,” later in this chapter, can help you determine this number. This money needs to be deposited in escrow before the bank will fund the loan.
- ✔ **Cash-reserve requirements:** Some bank guidelines require very specific cash reserves. *Cash reserves* are the funds you have left in savings or investment after you put all the required funds into the project. The guidelines vary depending upon the loan type and the institution making the loan. Banks commonly base reserves on multiples of the PITI. Most lenders want to see anywhere from 2 to 24 months PITI verified as reserves. The number of months depends on the loan product's risk. No-income qualifier loans and low credit scores can boost the amount of reserves required.
- ✔ **Money to support income:** The banks want to know that the cash you have in the bank reflects your earnings. This information is especially important when using a loan where you aren't providing any income documentation. The guidelines for this amount vary from bank to bank. Often the bank doesn't have clear guidelines, simply saying that the situation needs to make sense. For example, if you're claiming to make \$12,000 every month, the bank may be concerned that you average less than \$5,000 in cash in your bank account. Sometimes the bank sets a specific rule, such as having two months' stated income in the bank (in this example, \$24,000).



Ask your loan officer to help you determine the specific amount of cash necessary to qualify *before* you provide any asset information such as bank statements. If you show the bank that your assets are insufficient, you may be stuck — no matter what you do to build them up later. Discussing the guidelines with the bank in the abstract is okay, but the bank must use any documentation that you give it. A mortgage broker may have more flexibility in only providing the most recent information to prospective lenders.

When banks verify your *liquid assets* (cash and assets that can be turned into cash quickly, such as stock or money market funds), they want to make sure the money has been there for a period of time and not recently borrowed to beef up your account, causing the need to make payments or pay it back. When new money magically appears, the bank always wants to identify the *source of funds*. The underwriter looks for the 60-day average balance to determine if the money is *seasoned*. If you don't currently have seasoned funds, you may have to wait 60 days before applying for the loan.



An experienced loan officer knows the banks' quirks they're working with and can guide you through the best process to meet their particular cash guidelines. For example, some banks accept unseasoned funds if they came from a line of credit secured by real estate. The earlier you address the issue of cash with your loan officer, the better chance you have of fixing the problem before the lender sees it.

Lenders don't treat all money equally. Lenders give different values to your liquid assets:

- ✓ **Checking and savings accounts:** Lenders accept 100 percent of the seasoned balance in these accounts.
- ✓ **Stock:** Lenders accept 100 percent of the vested, seasoned balance in these accounts, provided they're publicly traded and verifiable.
- ✓ **Retirement and 401(k):** Lenders accept only 50 to 60 percent of these balances, accounting for taxes and penalties assessed by the government on early distributions.
- ✓ **Company accounts for self-employed:** Some lenders accept 100 percent of the seasoned balance in these accounts, others only accept 50 percent, and still others don't let you use them at all. You can sometimes move the money out of your business and into your personal account with documentation and a letter from your company's CPA stating it will do no harm to the company.



## On the appraisal

The appraisal represents the marketable value of the lender's security — your new home. Custom home appraisers have the difficult job of determining the value of a house that doesn't yet exist. Truthfully, appraisers can't tell you what the real value is for a house, because the only true, real value is what someone is willing to pay for it. What they *can* do is give you an assessment of your home's probable value based upon comparable properties that have sold in the area within the not-too-distant past.

An *appraisal* is a regulated form that describes every detail of your property based upon the appraiser's physical inspection, as well as the plans that you provide. The appraiser probably also asks you for a breakdown of the cost for your build and a description of the materials you're going to use. The bank looks at the appraisal's first page to make sure that the property's planned construction satisfies bank guidelines.



Lenders require the appraiser to find *comparable* properties, that is, properties that are close in size to your own, that are within a mile in location, and that have sold within the last six months. Finding properties that meet these rules isn't always possible, but the appraiser needs to get as close as he can.

Perhaps the most important page of an appraisal is a graph of three or more comparable properties, adjusting their values based upon the ways they are better or worse than your custom home. Look at Figure 9-1 for an example of how these adjustments impact the adjusted value of the subject property.



The appraisal is the most subjective part of the loan process, and the bank often reviews an independent appraisal and decides to use a value that is somewhat less than what is stated. If the bank uses a reduced value to qualify your loan, the bank lowers your loan amount forcing you to make up the difference out of pocket. Never assume that the bank will take the appraisal at face value — the process can sometimes be arbitrary and perhaps even a bit unfair.



Many people pressure appraisers to push their property's value as high as possible, which can backfire, however, when word of these tactics gets back to the lender. If the lender feels the property value is stretched, you can be sure that the value will be drastically cut, lowering the loan amount. Our advice is to let the appraiser be a bit more conservative, if the value is enough to support your loan. It works even better when your loan officer knows which appraisers your lenders favor the most.

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