



# Plan for Profits

## Cut Direct Construction Costs

Presented by:  
**Charles C. Shinn, Jr., Ph.D.**  
**Ed Hauck**

**February 27, 2009**  
**11:00 AM EST**



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**BUILDER  
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- Strengthening relationships between builders and manufacturers
- We offer **over \$2500** in incentives per unit constructed
- Our program allows you to focus on negotiating to get the best price without worrying about rebates
- We manage the incentive programs and follow up with manufacturers to collect money so you don't have to

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- **HOPE International (HOPE)** has been designated as our preferred charity. HOPE is a Christian faith-based, 501(c)(3) non-profit organization focused on alleviating physical and spiritual poverty through microenterprise development. Through HOPE's microenterprise development process, individuals living in poverty receive small loans that build businesses and change lives.
- **Houses for HOPE** is a 501 c3 non-profit organization established to partner with homebuilders to build charity homes – generating proceeds to benefit HOPE. Houses for HOPE works with builders, who donate all or a portion of lot, profit overhead – and their trade partners (subcontractors, suppliers, and consultants) who donate or discount labor, materials, and services. Once the house has sold, profits go to HOPE International which uses 100% of the proceeds to help thousands of people around the world build their own businesses helping their families escape the ravages of poverty

For more information on how to participate in Houses for HOPE, contact Michael Lennon ([mlennon@hopeinternational.org](mailto:mlennon@hopeinternational.org))



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# Signs of Recovery Emerging

- Since beginning of year have been getting good news from builders across the country
  - Traffic has increased
  - Serious buyers



# 2009: Transition Year



- Single family starts will bottom at 450 to 500 thousand
- Housing prices will fall back to the 2002/2003 pricing levels
- Market will stabilize at bottom
- Not going to see a very quick resurgence
- Can begin to plan for profitability

# Become Profit Oriented



- Establish a profit objective
  - You need a target
    - Obtainable
    - Motivational
- Focus on items within your control
  - Pricing of homes
  - Controlling construction costs
  - Maintain appropriate operating expenses for planned sales volume

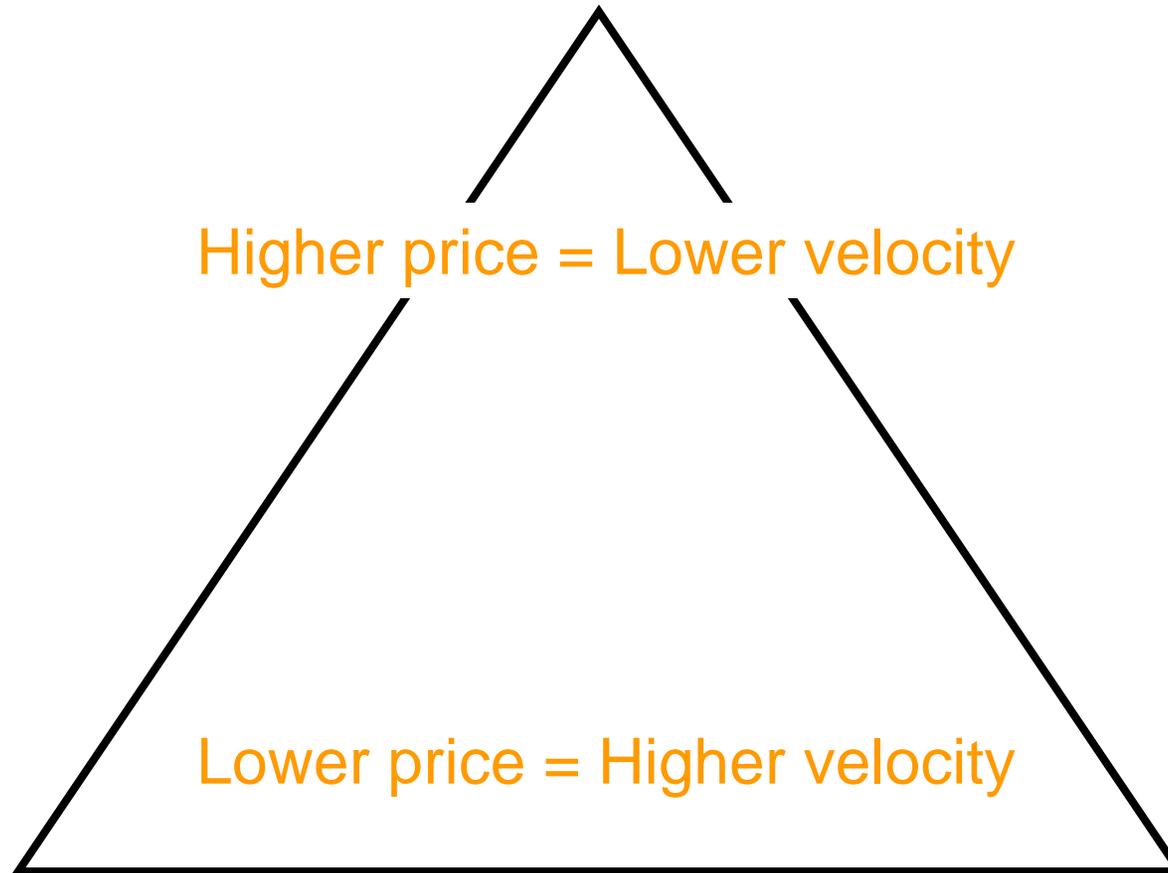
# Components for Good Profits



- Sales velocity
- Sales price
- Costs of construction
- Operating expenses

# Affordability Triangle

## *Sales Velocity*



Functions in all price ranges

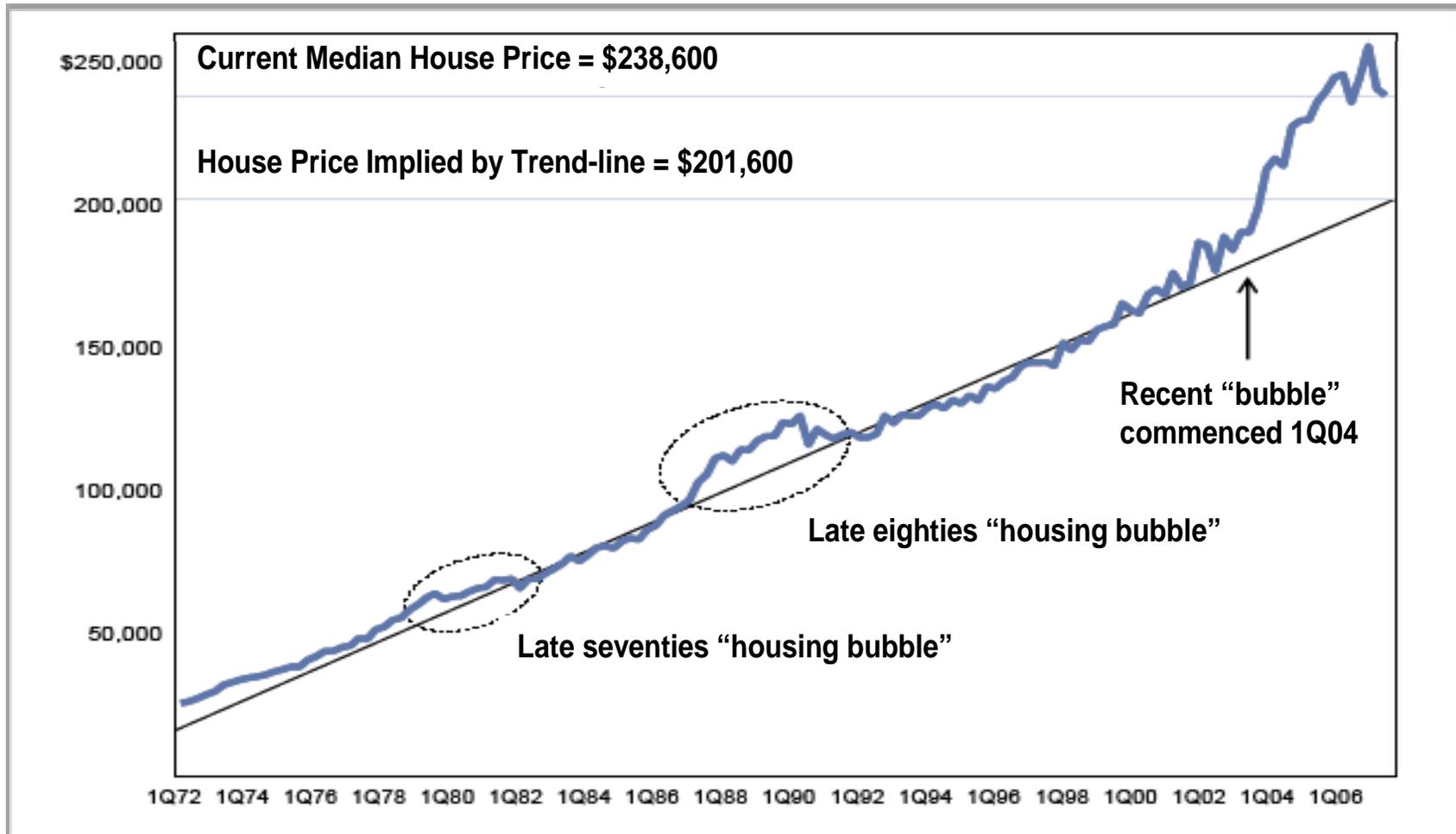
# Affordability Deteriorated

- Sales Price moved up the affordability triangle
  - Home value to household income
  - Home value to rental rates
- Loss of extremely lax and creative financing
  - Easy qualifiers
  - Low down payments
  - ARM's
  - Teaser loans
  - Interest only
  - Piggybacks



# House Prices Compared to Long Term Trends

1972 - Sep 2007



Source: Goldman Sachs

# Decrease Price to Create Velocity

- Most communities need at least three sales per month
- Discounting doesn't work
  - Reduces net profit per unit
  - Generally doesn't impact velocity much



# Establish Target Sales Velocity (for each community)

- Return on investment
- Viability of community
- Fixed expenses in community
- Activity levels necessary to motivate
- Production capacity



# Sales Price

- Market sets the sales price range
- Builder modifies sales price marginally
  - Impacts sales velocity
- Set base sales price to obtain appropriate velocity
  - Market research
  - Appraisers
  - Realtors
  - Multi-Listing Service



# Setting Sales Price

- Sales price may need to be set below market
  - Prices are still falling
  - Need to drop to history trend line (see Exhibit II)
  - Price to be competitive with resales
- Sales Price and Velocity
  - Generate revenue
  - Revenue – (costs and expenses) = NET PROFIT





# Planning for Profits

	Factor	Budget
<b>Sales Price</b>	<b>1.0000</b>	<b>\$200,000</b>
Profit	0.1000	20,000
Land	0.2000	40,000
Financing	0.0400	8,000
Marketing	0.0600	12,000
Indirect Construction Costs	0.0300	6,000
Warranty	0.0050	1,000
General & Administrative	0.0450	9,000
Historical Slippage	0.0200	4,000
<b>Total Direct Constr. Costs</b>	<b>0.5000</b>	<b>100,000</b>



# Don't Sacrifice Profits

- **DO NOT** treat profits as a residual
  - Establish a target profit rate
  - Profit is the objective
- Set market sales price for velocity
  - **Not** a variable
- Deduct your target profit – **FIRST**
  - **NOT** negotiable





# Deduct Fixed Costs

- Deduct land cost (*builder retail*)
  - May need to adjust land price to current market
- Deduct operating expense allocations
  - Based on anticipate sales volume
- Deduct historical slippage rate
  - Non budgeted cost - variances
- Deduct warranty expense allocation
  - Historical average warranty expense
  - It is a cost to be planned for





# Determine Direct Cost

- Remainder is available for direct construction costs
  - This is the residual **NOT** profits
  - Direct construction costs is the variable
  - Need to design and build house for this amount of money
  - Develop target budgets for direct construction costs
    - Trade off direct costs, **NOT PROFITS**
- Lot and direct construction cost should be about 70% of sales price



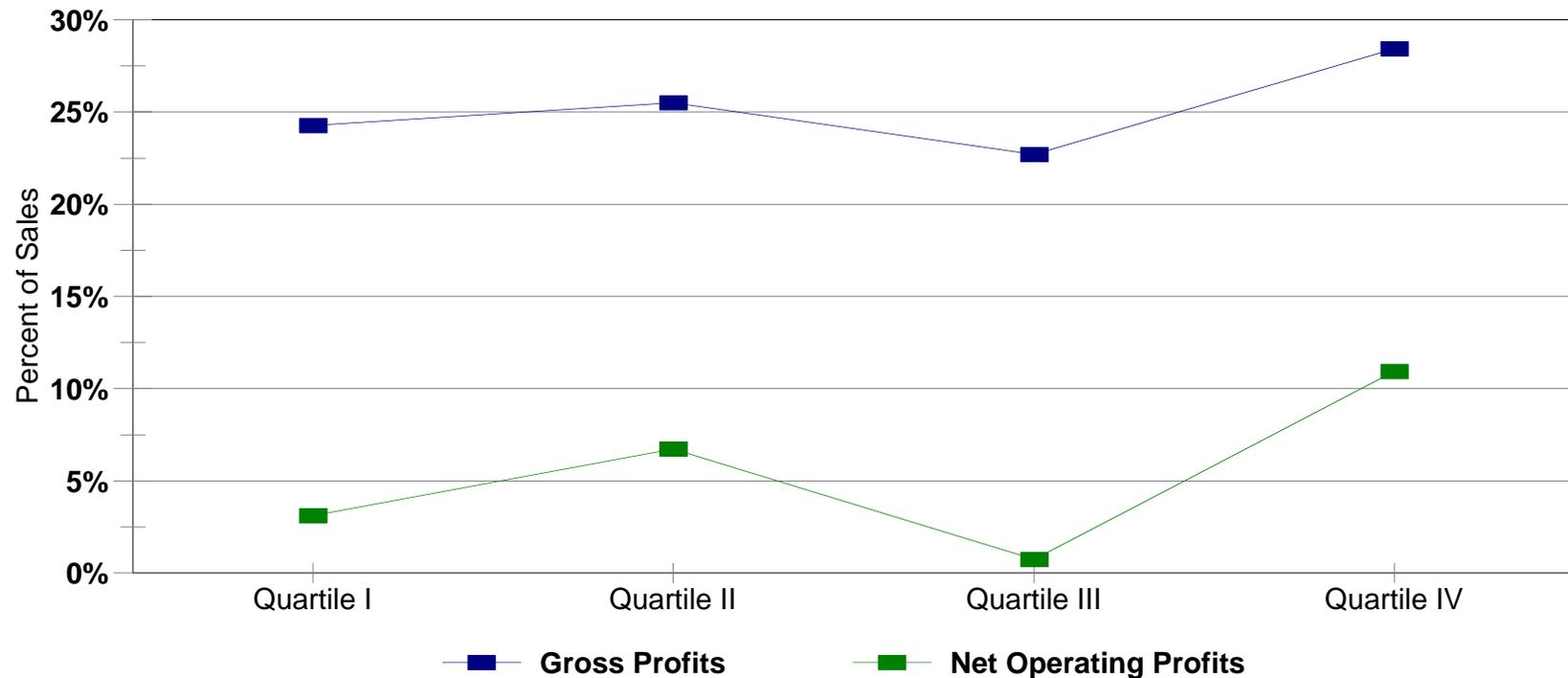
# Control Direct Costs

- Greatest potential for increasing profitability
  - Largest classification of costs
    - Normally over 50% of sales
  - Increases marginal rate of profitability
- Gross profit analysis
  - First line of defense for net profitability
  - Can't have good net profits without good gross profits
  - Eliminate lowest gross profit plans
  - Change product mix to higher gross profit plans

# Can't have good net profits *without good gross profits*

## Relationship of Gross to Net Profits

2007 Financial Study



# Analyze Standard Specifications

- Strip standard specification to basics
  - Need to go through at least three times
- Reduce amount of standard specification
- Review quantity, quality, grade and details of standard features
- Change specs from 1st floor to 2nd floor
- Conduct cost/benefit analysis
- Add back items giving adequate returns (*maybe*)
- Create options and upgrades with rest



# Eliminate Waste and Excess

- Trash pile represents lost profit
  - Only tip of the iceberg
- Police job site
  - Messy job sites lead to waste
- Watch for diverted materials
- Return all excess materials for credit
  - Don't move it or store it
  - Get it out of future estimates



# Analyze *ALL* Variances



- Document all fill-in orders and extra work
- Use variance purchase orders
- Should be less than 1% of Direct Costs
- Determine cause of each variance
  - Use variance codes
  - No miscellaneous category
  - Analyze by reason codes

# Eliminate Most Variances

- Variance elimination
  - Variance review meetings
  - Plan review meetings
  - Quality review meetings
- Document actions taken
- Purpose is to eradicate variances



# Inventory Material Deliveries

- Make sure everything is acceptable
- Eliminate back orders
- ***DO NOT*** accept substitutions



# Scopes of Work for *ALL* Trades

- Get the grey out
- Implement a checklist for trade contractors
  - Inspect their own work
- Inspect your expects
  - At least random inspections of each trade
  - Keep them honest
- Assure work is complete and accurate
- Reduces need for return trips



# Consistent Working Drawings

- Detailed scopes of work for architect
  - Details
  - Consistency
  - Accuracy
- Make sure architectural plans include necessary construction details and material assembly techniques
  - Consistent working drawings



# Complete Review of Costs



- Question everything
  - Question engineer
  - Question truss designs
- Analyze construction efficiency
  - Number of corners
  - Two foot modules
  - Roof pitches
  - Wall construction techniques
  - Flooring system

# Continuously Evaluate Costs

- Continually look for new and alternate materials
  - Maintain open lines of communication with suppliers and trade contractors
- Implement material saving techniques
  - Get the whole team involved
    - Designers,
    - Engineers,
    - Superintendents,
    - Trade contractors,
    - Suppliers



# Conduct As-built Audits

- Home is built right
- Assure material used as intended
- Instruct workers in proper use of materials
- Most popular plan tends to get fat



# Improve Estimating & Purchasing

- In-house detailed quantity survey estimating
  - Get the fudge out of the bids
  - Most builders do not have the talent
- Competitive bid on unit prices, **NOT** job
  - Don't need to continually get bids
  - Simplifies data base maintenance
- Develop a unit price database



# Improve Estimating & Purchasing

- Join Builder Partnerships
  - Take advantage of manufacturer rebates and incentives
  - Stay informed on new products and trends
- Implement formal purchasing procedures
  - Use written P.O.'s
  - Use written variance P.O.'s
    - Processed prior to order or work
  - Pay from purchase orders not invoices



# Work with Trade Contractors

- Become the employer of choice
  - Reduce number of trips
  - Eliminate dry runs
  - Help them improve efficiency
- Work with them on reducing costs
  - Alternate materials
  - Alternate construction techniques
- Establish a trade council
  - They are an integral part of **YOUR** team
  - Representative from each critical trade
  - Monthly meetings



# Direct Construction Costs & Profitability

- Historically major cause of low profitability
  - Land and direct cost should **NOT** exceed 70%
  - Typically 78% to 85% of sales price
- Greatest potential for increasing profitability
  - Largest cost classification
  - Variable cost
  - Increases Marginal Rate of Profitability
- Need to continually Monitor, Control and Reduce
- Attack on **ALL** fronts





# We Can Help, Too

- Assistance to develop a financial plan
  - Work sessions (*Limited to 5-20 attendees*) at a cost of \$100 per attendee.
  - If you want more specific help, we can probably get you on the right track with a one hour personal coaching session, at \$500.



- Individualized coaching
  - For the most impact, sign up for \$400 per month for two 30-45 minute session per month, payable or cancellable quarterly.



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- Sale of assets

**Contact Emma Shinn at [eshinn@theshinngroup.com](mailto:eshinn@theshinngroup.com) to discuss service options.**



## Upcoming FREE Webinars

- Sales: The Power of Scripts
  - March 5, 4 PM EST
- Looking Ahead: Home Design and Consumer Preferences
  - March 6, 11 AM EST
- Value Engineering your homes
  - March 13, 11 AM EST
- Simplify the Purchasing Process
  - March 27, 11 AM EST

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# Questions & Comments

