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- » Getting ready for the custom-home process
- » Considering the finances
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Chapter **1**

The Custom-Home Process in a Nutshell

Many people, at some time in their lives, want to own 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.

According to the National Association of Home Builders, more than 20 percent of new homes in the United States are custom homes. That means more than 175,000 custom homes are built every year. For each person building a custom home, several 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. Custom homes are popular, so 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've 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've 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:

- » 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 8, 9, and 10.)
- » 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 7.)
- » Is my relationship strong enough to survive this process? (See your therapist.)

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 one. Do your homework and interview as many people as you can 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.



TIP

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've 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 craftspeople. 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 budget is \$500,000, then what each piece costs isn't important as long as all the pieces combined total \$500,000 or less.



REMEMBER

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 as long as it fits your finances, you're in good shape.

Asking yourself about affordability

Of course, you've heard horror stories about custom-home projects that have gone seriously over budget. They go over budget for many reasons, but usually the main culprit is that the homeowners didn't spend enough time determining what they can afford. Obviously, if you're building well below your means, going over budget is easily rectified by using your own cash. But running out of money is the number-one 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 on how much money you're willing to put toward the project. Chapter 8 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. Make sure you consult with a financial adviser. We provide tools and Kevin's expert financing assessments in Chapters 9 and 10.

- » **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* (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've found your emotional limit, you can design your project to fit your comfort zone.
- » **What's your cushion and tolerance for risk?** As 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've 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 retirement fund) you're willing or unwilling to tap into.



REMEMBER

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 accounts. Even if they did, putting it all into the project wouldn't be a good idea, as we explain in Chapter 8. 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 their 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 banks don't want to foreclose on your home — they're not in the house-selling business. Worst of all, they don't want to foreclose on an unfinished construction project, when the property is neither an empty lot nor a finished home, but something in the dreaded middle. 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 who've gone before you.



TIP

Put yourself in the lender's shoes. If you were loaning a friend 80 percent of the money to build his home, you'd 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 9 and 10, you can easily navigate the approval process, as well as the funding process (see Chapter 11). 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 on 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.
- » **Loan officer:** Your loan officer needs to be involved early and throughout the entire process. You may need to start with a refinance or credit line to get liquid (see Chapter 8). You want to finance the land (see Chapter 3) and do it consistent with the construction financing (see Chapters 9 and 10). Your loan officer can help you through these steps. Lucky for you, Chapter 9 also has good advice on picking the right loan officer.
- » **Real-estate agent:** You may need a real-estate agent to help you find and purchase a lot, as we discuss in Chapter 3. They also play a role when it's time to sell your existing home.
- » **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 who 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 7.

- » **Surveyor:** This person makes sure you know where your land begins and ends — a necessity for designing a 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).
- » **Design review committee:** You can't always build what you want. This committee dictates what it wants to see in your design (see Chapter 6).
- » **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 (see Chapter 10).
- » **Insurance agent:** Chapter 2 spells out all the insurance you need for the project. This person provides the goods — they'll be busy.
- » **Material suppliers:** Sticks and stones all have to come from somewhere. Some projects have many sources (see Chapter 7).
- » **Subcontractors:** Each one is an expert . . . just ask them. Artisans and craftspeople build each different system in your house. Chapter 7 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 people 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 (see Chapter 7).
- » **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 11.)
- » **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 (see Chapter 7).

- » **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 16 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'll 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: Fifty steps to a custom home

You're probably wondering why the custom-home process has so many people involved. The simple answer: The 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, including loan officers, 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 6).**

- 12.** Pick all your fixtures and materials (see Chapter 5).
- 13.** Submit the plans for building approval (see Chapter 6).
- 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 Chapters 2 and 7).
- 17.** Apply for a construction loan (see Chapters 9 and 10).
- 18.** Get an appraisal based on future value (see Chapter 10).
- 19.** Get final approval for permits and pay fees (see Chapter 6).
- 20.** Close escrow on the construction loan (see Chapter 9).
- 21.** Set up a disbursement account (see Chapter 11).
- 22.** Set up communications with the contractor and subs (see Chapter 7).
- 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 heating, ventilation, and air conditioning (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 a certificate of occupancy (see Chapter 15).
47. Roll to permanent financing (see Chapter 17).
48. Install the landscaping, including the deck, pool, spa, and so on (see Chapter 16).
49. Sell your old house (see Chapter 17).
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 house in progress looks like.

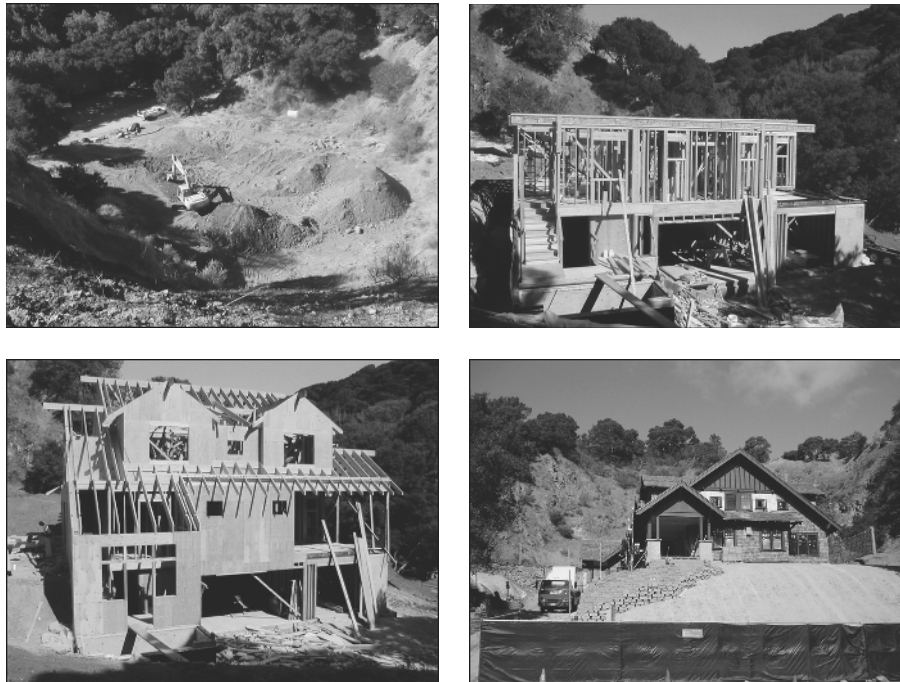


FIGURE 1-1: A house in progressive stages of construction. From site prep through foundation, framing, and exterior work, this home took more than eight months to build.

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 had clients come to his office asking if they can move in by Christmas, to which he always responded, “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 nearly 40 years of experience:

- » **Land acquisition:** This step depends upon the availability of land in the area you want. Land is hard to find, so pinpointing the exact time is difficult. Most of Kevin’s clients looked for land for three to nine months before finding something they liked. Purchasing the land, including the escrow and due diligence periods, can take anywhere from 30 days to six months.
- » **Home design and approval:** 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 make your choices quickly. Kevin had some projects that took 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. In reality, 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 less than 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 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 partner and kids stay with me if I mess up the project?



WARNING

If you honestly answered no to any of these questions, you probably need to hire a contractor (see Chapters 2 and 7). 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 may save. If you're wrong, it can cost you far more money than you planned to save in the first place.



TIP

One option if your answers were somewhat mixed is to hire an owner-builder consultant. One company called UBuildIt (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 percent 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. Ask your contractor for a detailed breakdown of how they calculate costs.



REMEMBER

Where materials are concerned, discount suppliers such as The 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 them to make some money without your having to pay more. In some cases, they 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 you wait for the subs to become available.

Finding and managing subs

Hiring and managing subs is the hardest part of being an owner-builder. 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 they trust to be timely, efficient, and good craftspeople. 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.



REMEMBER

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 they're finished and they've been paid. (Check out Chapter 7 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 may 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 the 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 that lend to owner-builders do so with stricter requirements than for regular construction loans, such as loaning less money relative to the appraised value. Other banks 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 9.