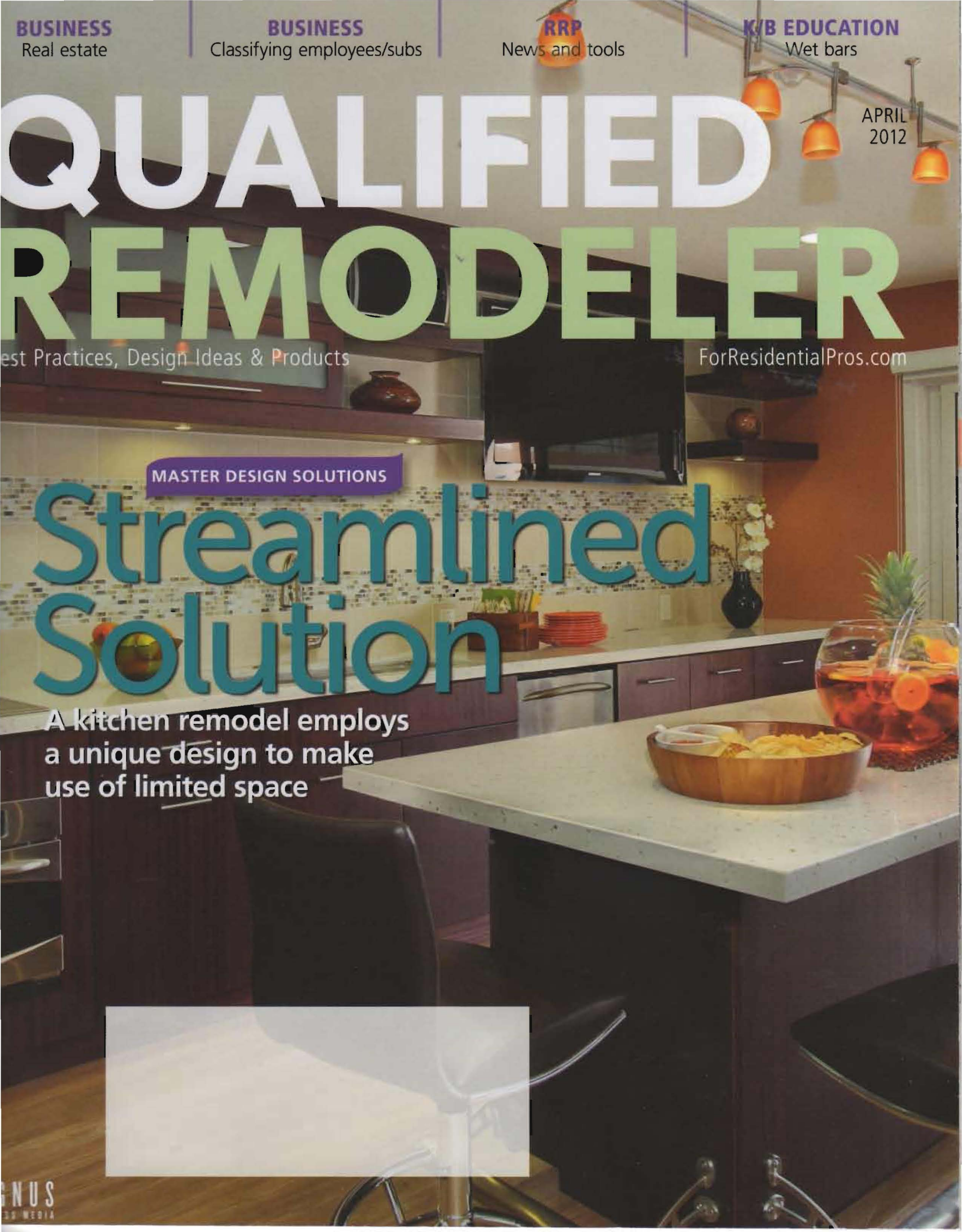
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By Jim LaVallee and Rick Bennett

From REMODELING to Real Estate

Six Steps Can Help You Navigate the Real-estate Market

The residential real-estate market has received mostly bad press during the past four years. In spite of challenging times, our firm has found it to be one of the most productive markets for our speculative construction business. In the speculative segment of the market, few companies have the financial ability or the stomach to renovate homes with no buyer in hand.

The limited volume of new homes being built combined with few speculative renovations means the market does not have enough high-quality move-in-ready properties. Because buyers have limited choices, our projects have sold quickly and produced high margins and annualized returns on capital invested.

Taking on your own project can be extremely rewarding from monetary and creative perspectives. However, it is hard work and unless you are a remodeler who also is an attorney, real-estate agent, designer and appraiser, you need to do a lot of research and assemble a team of professionals to complement your skills. There are many things that can go wrong if you do not anticipate them. However, when a well-thought-out profitable project is successfully completed, you will enjoy a sense of satisfaction and accomplishment that lasts much longer than the financial reward. That being said, there are six steps that must be considered in all projects.

Step 1: Assemble Your Team

Unless you are a renaissance man/woman, you are probably going to need input in one or more areas. Although you're a whiz at finding subcontractors who provide quality craftsmanship at reasonable prices, you will need to take your time diligently researching real-estate agents, attorneys, appraisers, etc.

You may think you can cut out the real-estate brokerage community because you don't want to pay for a broker's services. Our firm never takes this approach. We view real-estate brokers as one of the main customers to which we market our business each day. The more the brokerage community understands the quality of your finished product, how reasonable you are during negotiations and the service you provide after the sale, the more your business will grow.

Unless you live in a small town, it is rare to find a single broker who specializes in all price points or sub-markets (small geographic areas that are identifiable to locals). If you have access to the multilist, search for brokers who have bought and sold the same home in a short period of time. These transactions are likely to involve renovators, and the agents are more likely to understand the process.

Step 2: Know Your Buyer

Good local brokers also are important to helping you understand the buyers for the home you're renovating. How old is your buyer? Does he or she have or plan to have a family? Why does he or she choose to live here (schools, proximity to work)? How much can the buyer afford? What will neighborhood sales support? To be successful you need to understand the sub-market you are going to buy and renovate in and the substitutes for that sub-market. Buyers are going to shop in both.

You must look at a lot of real estate and talk to a lot of people. There is no substitute to kicking the tires in the real-estate business. Words, like renovated, updated, refurbished, etc., are thrown around in this industry like confetti. You need to see what your competition is offering. Look at as many homes as possible, including active listings and sales. Working with successful real-estate agents in your sub-market is an excellent way to streamline this process, but you must see listings yourself.

Epic Development

Spence Avenue is a whole-house renovation. Epic elopment converted the second-floor apartment t was under existing rooflines, creating a 3/4-story ne while maintaining the existing scale and front ation. Two bedrooms and baths also were added.

Step 3: Formulate a Plan

This is a multifaceted phase depending on the scope of the project. For renovations that are more cosmetic in nature, such as replacing the kitchen cabinets or refinishing the floors, it is not as difficult to develop the plan because the structural and mechanical systems probably won't have changes.

For more extensive renovations, such as linear or vertical additions or interior floor plan changes, this is a critical phase. There are many things to consider.

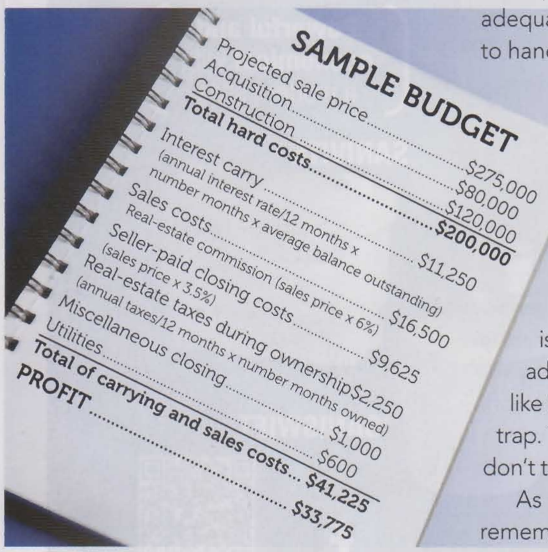
First, you probably know you must determine whether it is legally possible to make the changes. Older homes can be historic, built over setback lines, be too dense on the site, be located too close to a creek or have other challenges that motivate the local municipality to deliver the dreaded "Stop Work Order." Invest time to understand the general zoning issues in your area and how the rules are applied for renovations versus new construction. Talk to local building department officials and have them review their process with you.

Second, you must determine at what point an extensive renovation crosses the line and becomes unprofitable or results in such a high cost that it would have been easier to tear down the entire structure. The big-ticket items (roof, mechanical systems, foundations, window

Epic Development's work on 171 Whitefoord primarily was a cosmetic whole-house interior renovation with minor front façade changes, including rebuilding a dormer and adding stone accents.

placement/replacement, etc.) can add up on large-scale projects. If your project is going to involve repairing or replacing the majority of the house, you need to consider building new as an alternative to renovating, or you should acquire the property for land value so any incremental value of the structure is a bonus. Don't overbuild the project; spend the money where the buyers will pay you for your efforts.

In addition, prior to acquiring the property, consider using a home inspector to look at the house. Your inspector may notice a deficiency that is going to impede the project from being sold. Almost all buyers these days will have a home inspector, so it is unlikely the buyers' inspector will miss the problem. Let the inspector know your general plan for the home, so he or she can determine whether the home will need further upgrades. For example, electrical service that is adequate for a two-bedroom home may be undersized to handle a master-suite addition.



SAMPLE BUDGET

Projected sale price	$275,000
Acquisition	$80,000
Construction	$120,000
Total hard costs	**$200,000**
Interest carry (annual interest rate/12 months x number months x average balance outstanding)	$11,250
Sales costs (Real-estate commission (sales price x 6%)	$16,500
Seller-paid closing costs (sales price x 3.5%)	$9,625
Real-estate taxes during ownership (annual taxes/12 months x number months owned)	$2,250
Miscellaneous closing	$1,000
Utilities	$600
Total of carrying and sales costs	**$41,225**
PROFIT	**$33,775**

Step 4: Create a Budget

Create a budget and stick to it. Unanticipated costs will come up and when they do, you need to try to win back some of the overage by saving on other line items. Always have a contingency plan, but try not to use it. Increasing the scope during construction is easy to do because it seems to make sense to add one more thing that would be nice or you would like if you lived there. Don't fall into the scope-creep trap. This is not the home you are going to live in, so don't treat it that way.

As a successful new real-estate investor you must remember why you bought the project and what your stated plan was for the property. Manage the budget to that plan. Don't forget to add the cost of interest carry and sales commission to the budget.

For example, let's assume you need a total of $200,000 for the physical construction. You expect it will take nine months to renovate and sell the home. With 10 percent interest carry, 6 percent real-estate commission, 3 1/2 percent seller-paid closing costs and annual taxes of $3,000, you should assume the average funds outstanding are about 75 percent of the total of $200,000 hard costs. See the table on this page for a sample budget.

Unexpected costs can always arise. We once purchased a ranch home that was in very rough condition. The budget was large because we decided to do a whole-house remodel. The prior owner had kept dogs in the home and did not let them out to relieve themselves. There was an extreme pet-odor issue, but we had budgeted chemical treatments. However, the situation was so severe the odor could not be remediated after multiple attempts. Ultimately, the only "guaranteed" solution was to gut the hardwood flooring and subflooring in the house. The budget included the replacement of most of the hardwoods, but the subflooring replacement and additional labor were not anticipated.

The positive was the home had all new hardwood floors. The negative was the new subflooring cannot be seen by buyers and likely does not yield a higher sale price. To "pay" for this without going over budget, we had to gain some concessions from our Sheetrock, trim and painting crews on the cost of their labor. We also made some adjustments in the tile and lighting selections by spending more time hunting for closeouts that allowed the quality to remain high but at a lower cost. The project came in on budget. It had multiple offers and actually sold after just three days on the market.

If a cost overrun happens early, you have a better chance to recover by spreading the overage across multiple remaining categories. You always want to save your budgeted "contingency" line item for the end of the project because if the surprise happens toward the end, there are limited ways to adjust.

Step 5: Set Up a Realistic Capital Structure

Make sure your capital structure is realistic and has contingency and holding costs built into the total funding required. The amount will depend on the project scope (months of construction) and how aggressively you plan to set the asking price (months of marketing).

You can estimate the number of months for construction, but work with your real-estate brokers to estimate the marketing period. Add several months to the total for a cushion. The interest clock ticks all night, so don't leave out this cost. Don't underestimate the timeline or you could end up paying costly refinance or extension fees. You may also have to cut the price quickly to sell the property. If the property has no showings or if there are plenty of showings but no offers, you must cut the price.

Step 6: Manage the Construction Process

Although you may trust the subs you have hired for your project, you must be on the jobsite. You have to inspect the work and address unanticipated issues because how you handle them on your project may be different than when you're hired by someone else.

Make sure you and your contractors are carrying the proper builders risk, liability and workers' compensation insurance. Often, builders risk is overlooked when renovating an occupied home because the homeowner has insurance on the structure and there is typically minimal risk of stolen materials. However, when working around a vacant property you own, you need builders risk coverage to cover the structure and materials.

Getting into the real-estate market is a learning process, so be ready to research everything. Although you will be more efficient with each project completed, there is no substitute for hard work. **QR**

Jim LaVallee is director of marketing and development, and Rick Bennett is director of design and construction for Atlanta-based Epic Development, which focuses on new construction and renovation work primarily on a speculative basis.

1330 Conway Road was a ranch to bungalow whole-house conversion. Epic Development removed the roof, raised the ceiling heights on the first floor from 8 to 9 feet, and added two bedrooms and baths.