

Methods to Reduce Costs in New Home Construction

This article describes methods to reduce the overall cost of construction for a new home. The new home construction industry has been hit hard by the devaluing of real estate during the four-year period of 2008 to 2012. There is no reliable source indicating any increase in real estate market value for the foreseeable future. So how does a contractor make a profit when building new homes in the construction industry?

There are two primary methods of reducing costs of construction. The first is cost negotiation and the second is cost shifting. These two methods have several tools in each to achieve overall price reduction. The following describes each method and the respective tools within each method that you can use to achieve overall cost reduction.

Cost Negotiation

This is the most effective way of reducing overall costs for the construction of a new home. For the new home builder, you need to review all of the subcontractors and material suppliers and determine the top 10 vendors for this service or supplies. The key is to have a sit down with the respective folks and discuss the following with them:

1. The real estate industry as a whole and the importance of working together for survival until the market returns to better times.
2. As the contractor, you have been pinched by all the factors involved, from the local government raising fees to cover their costs to the overall price reduction for the final sales price. Therefore, all the parties involved need to cooperate in reducing their fees for the services they render.
3. Percentage of FMV Tool – this is a costing concept whereby the FMV dictated the value of the services provided. If the bricklayer was able to perform his services in the past for 4.6% of the fair market value of the home, then his price today should be 4.6% of the fair market value of the home contract price. This tool is in effect a cost sharing concept based on the fair market value of the past and present.
4. Continuity Tool – this price reduction agreement is based on a platform of mutual agreement to get through the hard times. In effect as the contractor you want to negotiate a long term agreement over several houses over extended period of time in exchange for a reduced price.
5. Cash Discount – this tool is no different than an early payment discount. You agree to pay his bill in a shorter time period to ease his cash concerns in exchange for a discount on the total amount paid. You will take the discount at the point of payment. Your vendor should agree to around 1.5 to 2% as the discounted amount. Some vendors will go upwards of 10% given the more difficult economic times.
6. Agree to ways to reduce the overall cost burden for the project by helping the vendor reduce his costs. Examples might include shifting one of your laborers to his work crew while they are on the job site. Another method might include materials purchasing for the vendor from his supplier (especially if his supplier is one of your suppliers) in exchange for a reduced material portions cost on the contract. The following is an example of this at work:

The siding guy buys his materials from the same supplier you purchase the roofing and gutters from. Your siding guy charges you the cost of materials plus a handling fee of 14%. Well, by you purchasing

from the same supplier and having all the materials delivered at the same time could save the 14% for the handling fee. In addition, as a bulk purchaser of materials from that supplier, you could in effect receive a bulk material purchase discount.

1. In dealing with the broker for the sale of the home, you should be able to reduce the overall commission percentage from the market rate to a 4% level. Simply put, new homes sell faster than lived in homes. The market doesn't index the price associated between the two types of residential availability therefore, the broker isn't really losing anything in terms of costs. Actually his costs to sell a new home will be less overall because of the speed involved in getting the house sold. That key aspect of their business warrants a reduction in the commission. Furthermore, let them know that if they are not willing to do this, then you'll find a broker who will. Don't forget, all brokers utilize the Multiple Listing Service to alert all agents that this house is available for sale. This is the primary source of buyers for the house. An agent from another broker can show the home and sell the house as if it were their listing. So use this knowledge to your advantage and don't just request a commission reduction, tell them how much you are willing to pay, PERIOD.

Cost Shifting

In many industries this is known as risk shifting. In effect, shift onus of the cost associated with building the house onto the supplier and or vendor. The best tool for this is a more detailed contract between you and the vendor. You need to use highly detailed line items in the contract to shift costs back to the vendor or supplier. They absorb price increases in the interim, and they have to pay for certain auxiliary costs for the services they render. Let me explain through two examples:

Roofing: A traditional roofing agreement is that the roofer supplies the labor and materials to put on a certain quality material roof. Historically, they provide the actual shingles, flashing, pipe covers, vents and the labor to install so many square of shingles. Now reword the contract to state that they are responsible for the above plus the tar paper (felt), chimney vent cover, attic exhausts including installation, drip edge, and cleanup of all debris on the job site. In addition, they are not allowed to dispose of their debris into the site dumpster without a penalty fee for the cost associated with the disposal e.g. \$50 or \$35 fee.

Note what the above does, it shifts cost from the contractor to the roofer, most roofers will not counteroffer this type of contract because there is a low level of work volume in the current market. Since the roof is new, there is no need for a 'take-off' charge or the need to refelt the roof. Be sure to identify issues with other vendors that may drill or work on the surface area of the roof. If that vendor creates an issue, your roofer is going to try and stick it to you for the return trip. Honestly, you can't blame them. Return trips cost a lot more per unit of time than the original trip. So when negotiating with the other vendors, you should have a line in the contract that specifically states that any damage to another's trade work, those costs shall be borne by the vendor causing such damage.

Cabinets: If there is one area that the female buyer looks at closely, it's the cabinets and countertops. So use this understanding as the cost shifting tool. What typically happens is that the

cabinets are built offsite and installed once the sheetrock is up and mudded. The problem is that the kitchen never has the same dimensions as when the cabinet maker came out to measure the walls prior to sheetrock being installed. The plumbing is off, the electrical outlets are shifted to the other side of the stud etc. etc. So, shift this cost issue to the cabinet maker or to the vendor creating the issue for the cabinet maker. In the contract, let it be known that he is free and should measure the kitchen frequently as the trades complete their respective steps in the house. Any modification costs shall be borne by the cabinet maker associated with these trade nuances unless he can specifically identify the trade creating the problem. Trust me, he'll be out there often to reaffirm the measurements and modify the cabinet sizes to the appropriate widths. You can further shift some costs by having the cabinet maker install the trim molding or the back splash for not only the kitchen but for the bathrooms too.

Notice that the key is to shift work or costs to the vendor during his process of getting work done. I can't tell you how many times vendors limited their respective duties to just the item they provide. Any type of transitional issues are avoided like the plague. The flooring guy has no interest in the shoe molding or installing the HVAC vents once he is done. He'll tell you right up front, that's the HVAC guy's job. But on a job where the folks live in the house, he has to pull the vents and reinstall them. Why not for you? Shift the risks and costs to the vendors where it is most appropriate. Because there is such a shortage of work available in the industry right now, many will not bat an eye at signing a more detailed and risk shifting agreement.

By using cost negotiation and cost shifting a new home builder should be able to significantly reduce the cost of building the house. There are more tools available and I'll illustrate those in another article. The above requires the builder to truly understand how the house is built and what each vendor is responsible for in getting the house built. By shifting the responsibility to the appropriate party and negotiating the cost in more detail, you should see the price per square foot decrease to the more appropriate current fair market value

Courtesy: - <http://businessecon.org/2013/01/methods-to-reduce-costs-in-new-home-construction/>