

# EIGHT-PENNY NEWS

VOLUME 10 • NUMBER 11

AUGUST 1992

## Small Builders Feeling Credit Crunch

There has been a lot of publicity in the last two years about the problems builders encounter when trying to get construction loans. Yet until recently, small builders in most parts of the country have been able to get the loans they need without a lot of extra trouble. Now, despite news stories that banks are loosening up, the credit crunch seems to have "trickled down" to small builders. In several parts of the country, small builders, even those working with presold, noncontingent contracts, are having trouble getting adequate funding for the homes they want to build.

In the Midwest, two builders say their banks recently told them they won't

loan more than 70% of the value of the homes they want to build; both builders used to get up to 85%. On the West Coast, a builder says his line of credit was recently sliced in half. An Atlanta-based builder "with squeaky-clean credit" was recently forced to use his own home as collateral on a loan for a presold custom home.

And in New England, loans have been hard to get for everyone, including small builders, since the recession became official in early 1990. "It's as if the banks closed their doors to any type of construction lending," says Jan Wellin, executive director of the Home Builders Association of Hartford,

Conn.

Kim Nelson, vice president of Anderson Homes in Fredericksburg, Va., says that in the past six to eight months, many banks in his area have taken to offering only 75% of the sale value of a home for construction loans. Coming up with the other 25% is difficult, he says, especially after almost two years of recession.

Another problem is that even though the 20-year-old company's credit is "golden," loans are taking about five weeks to process. "Banks are throwing weights around our ankles and telling us to swim," says Nelson.

Michael Markstahler, president of Markstahler Inc., a remodeling and new construction firm in Champaign, Ill., says requirements in his area are significantly tighter than they were even a year ago. But because his local property values never soared the way they did in other parts of the country, loans are not as difficult to secure. In fact, Markstahler started a new homes division this year — a move that would seem incomprehensible to many builders elsewhere.

**Small builders felt the bite last.** The credit crunch, brought on by the recession, a collapsing real estate market, and tightening bank regulatory policies resulting from the savings and loan crisis, has taken longer to affect small builders because their lines of credit are smaller, according to the National Association of Home Builders.

Medium-size and large builders were hit first because much of their work was speculative and because they often had large unsold inventories of land and houses.

Construction loan policies tightened because bankers wanted builders to put more equity, and therefore greater commitment, into their projects, says Kevin McCullagh, vice chairman of the real estate division of the American Bankers Association. "Builders just want to borrow all they can. But banks want them to share more of the risk."

Small builders are feeling the effects of the credit crunch now because bankers are worried about their lack of assets. When a builder builds only one house at a time, everything depends on that one house. If the buyer "walks," the builder is stuck, McCullagh says. "Because of the recession, it's hard to guarantee that the buyers will still have their jobs once the house is underway. If the customer backs out of the deal, the small builder has nothing to fall back on and is likely to go under."

As for builders who are willing to pledge their homes and other personal assets as collateral, some bankers interpret this as a willingness to "hock" everything just to stay in business, he says.

**Looking for funds.** Some builders are seeking alternate sources of financing. Kim Nelson has financed some of his company's construction with loans from an investor.

*continued*

### STATE BY STATE

**New York:** The head of the state's consumer protection division, citing complaints about unscrupulous contractors, is calling for the state to require contractor registration and to set up a guaranty fund to compensate swindled consumers. The guaranty fund would be funded through registration fees. Similar laws were recently passed in Massachusetts (see story, this page) and Illinois.

**Connecticut:** House Bill 5643, if passed, would allow self-employed contractors who have been out of work for four consecutive weeks to collect unemployment benefits.

**Vermont:** Green Mountain Power and Central Vermont Public Service are offering cash rebates of \$30 to \$50 to builders and owners of new and rehabilitated residential buildings for the installation of energy-efficient lighting, refrigerators, and electric water heaters. For information, call Green Mountain Power at 800/499-5731.

**New Hampshire:** In the Granite State, this spring's legislative session brought builders little news — which was good news. The previous session had included consideration of impact fees and shorefront development restrictions. But there's been so little building in New Hampshire since then, says New Hampshire Home Builders Association Executive Vice President Samuel Reddy, that legislators seemed to feel there was nothing to regulate. "They finally recognized we're already dead, so why beat us," said Reddy. "There's a real feeling that the industry is down so bad you shouldn't put any constraints on it. Towns are actually starting to lean the other way." □

### Design a Deck and Win



If you're big on decks and use redwood to build them, consider entering the Home Mechanix/California Redwood Association Deck Design Competition. The competition has separate categories for building professionals and do-it-yourselfers; the first-place winner in each category will receive \$2,000; second- and third-place winners get \$1,250 and \$750, respectively. The six winning entries will be professionally photographed and featured in the July/August 1993 issue of Home Mechanix magazine. The decks must be made of redwood. To enter, you must submit photos, plans, and a description of the project. For rules and entry forms, see summer issues of Home Mechanix or contact the California Redwood Association, 405 Enfrete Dr., Suite 200, Novato, CA 94949; 415/382-0662. □

## Massachusetts "Builder Lemon Law" Not So Bitter

Massachusetts' new "builder lemon law" has turned out to be a bit of a sheep in wolf's clothing. To begin with, it affects only remodelers, not builders of new homes; and the "lemon law," as it is popularly known, hasn't turned out to be as bitter for contractors as the industry once feared.

"It's not really something to fear for most remodelers," says Garen Bresnick, executive vice president of the Massachusetts Home Builders Association, which lobbied hard to make the bill as reasonable as possible. "Legitimate contractors, who constitute 98% of the

*continued*

## From What We Gather

### **Painters using latex paints suffer negligible exposure to volatile chemical components**

that make up part of those paints, according to a recent study sponsored by the National Paint and Coatings Association. The study also found that the concentration of such components falls below detectable limits within six hours of application, suggesting that the impact of painting on indoor air quality is both brief and mild.

**Subcontractors earned only 0.9% profit** after taxes last year, compared to an average 1.3% profit for general construction companies, according to a survey by the Construction Financial Management Association. Part of the reason was delays in payment: Subs must wait an average of 63.5 days for payment, while construction companies collect in 50.6

days. Specialty contractors also typically have less work scheduled in advance — an average of 6.3 months' work under contract, compared to 13.5 months for general construction firms.

**Only 2,000 of the 6 million mortgages taken out in the U.S. each year are energy-efficient mortgages**, according to Bay Area Energy Consultants in San Francisco, Calif.

**If you think the construction economy stinks here**, be glad you're not in Canada. In Quebec, housing starts have plunged about 50% from 1991 figures, and more than one third of the area's construction workers are jobless. In Manitoba, starts have dropped more than 45%, while in Saskatchewan, single-family starts are down more than 49% over last year — the lowest figure since the

Canada Mortgage and Housing Corporation started keeping statistics in 1940.

**Bring your questions about indoor air quality (IAQ)** to the Environmental Protection Agency's new Information Clearinghouse. The agency will provide building professionals and the general public with specific information or bibliographies of literature concerning IAQ. Contact Indoor Air Division, (6203J), EPA, 401 M St., SW, Washington, DC 20460; or call 202/233-9030.

**A disclosure of defects** will soon be required of homeowners listing their properties with the real estate giant Coldwell Banker, according to *Radon News Digest*. The brokerage firm is the first national company to require disclosure of any knowledge of 14 different defects, including radon. □

## Energy-Efficient Builders Sharpen Skills

Energy-minded builders headed to the 1992 Energy Efficient Builders Association (EEBA) Conference in Research Triangle, N.C., last March seeking answers to such questions as: Why does mildew grow in the closet? Why is the cathedral ceiling raining? How can I talk my clients out of a spa and into a high-efficiency furnace instead?

Once again, the EEBA Conference proved to be a rich source of information for builders who want to improve energy efficiency in houses. This was not a convention where stuffed shirts sipped cocktails and compared golf strokes. Attendees came for technical talk, including sessions by builders, engineers, and researchers on mold, mildew and rot; duct leaks in forced air systems; crawlspace ventilation strategies; the health and environmental effects of building materials; and how to decode energy regulations and standards. The hallways buzzed between sessions with talk of new products that solve old problems, and of hard-won experiences of fellow builders, remodelers, and designers. Here's a sample of the information we gleaned:

- Recessed ceiling lights are ever popular among homeowners, but are difficult to seal. If left leaky, these penetrations can vent excess moisture into the attic. Use airtight fixtures instead. These are available from Juno, Prescolite, and Lightolier.
- Seal heating ducts with a mastic sealant, such as that manufactured by the RCD

Corporation (P.O. Box 54706, Orlando, FL 32854; 407/422-0089). Duct tape eventually fails, causing duct leaks that can bring cold air or harmful toxins into supply runs.

- According to the Department of Energy's *Moisture Control Handbook* (available from the National Technical Information Service, U.S. Dept. of Commerce, 5285 Port Royal Rd., Springfield, VA 22161), a moisture content of less than one percent (by volume) in a wall cavity can increase heat transfer by 100%. The handbook offers practical details for preventing such problems.
- Air conditioners are air coolers first and dehumidifiers second. Unfortunately, the most efficient coolers are the least efficient dehumidifiers. To increase humidity control, specify an air conditioner that allows you to increase the amount of air moving over the cooling coil during times of high humidity, or that includes a built-in air-to-air heat exchanger to pre-cool the incoming moist air before it reaches the cooling coil. These state-of-the-art features allow the cooling coil to be colder and remove more water from the air.

Next year, the conference should be even better. EEBA is joining forces with the Northeast Sustainable Energy Association, which has been having its own strong programs for years, and the Conservation Services Group to hold a joint conference in Boston, Mass., March 3-6, 1992. □

## Remodeling to Overtake New Construction

Remodeling may be dominated by small companies, but recent figures published by the National Association of Home Builders (NAHB) show remodeling is big business. According to Bryan Patchan, executive director of the NAHB Remodeler's Council, by 1995, the dollar value of remodeling will exceed new construction. The remodeling market reached \$100 billion in 1991.

The principal reason for

remodeling's continuing growth, says Patchan, is the aging of this country's housing stock. Each year, the number of new units produced is proportionately smaller than the existing inventory. Demographics also work in remodeling's favor. As America's baby boomers approach middle age, there are fewer young people to buy new homes. More people are staying put and fixing up the homes they have.

While the growth may be

good news to remodelers, it may introduce some problems. More people will be attracted to the business, making it more competitive. "Many of those who decide to get into remodeling will really have no business being in the trade. They won't understand the overhead or the service involved and they'll do a lot of price cutting," says Patchan. "To survive, remodelers will have to learn to compete with something other than price." □

### **Lemon Law, continued**

industry, should suffer nothing more than a little extra paperwork."

The basic provisions of the bill are as follows:

- All home improvement contractors must register with the state
- All home improvement contractors must biannually pay \$100 to \$500 (depending on the firm's size) into a "guaranty fund" that will be used to reimburse consumers defrauded by other contractors
- Written contracts specifying the contractor's name and address, the scope of work, the price, and certain consumer

rights are required for any work over \$1,000

- Contractors cannot act as mortgage brokers, lenders, or agents

These provisions fall far short of those originally proposed. The original versions of the bill were written after a series of *Boston Globe* investigative stories revealed numerous cases of home improvement fraud in the Boston area. Home improvement contractors had convinced unwary homeowners to take out large equity loans to pay for work that often turned out to be overpriced and poorly performed. The victims often ended up owing

more than their houses were worth; some were foreclosed upon by the lenders.

Responding to these reports, lawmakers proposed measures that the remodeling industry felt were unreasonable. The industry, led by the Massachusetts HBA and the National Association of the Remodeling Industry (NARI), succeeded in modifying most of these.

For instance, the guaranty fund, a provision established by the bill, was originally meant to provide relief as soon as a consumer failed to get satisfaction directly from the contractor. It now requires the consumer to exhaust legal remedies first. The fund was also originally

available to any defrauded consumer; now it is available only to those who used registered contractors. Consumers are thus given incentive to use registered contractors. Finally, the original bill allowed the state to bill registered contractors as necessary to keep the fund replenished; now it limits any contractor's contribution to a single yearly contribution based on firm size, never to exceed \$500. Even more importantly, says the HBA's Bresnick, legitimate contractors won't have to pay for the sins of unregistered fly-by-night operations.

With these changes, says Bresnick, "the law's biggest effect on the contractor who

treats his customers fairly will be the new contracts." The new contracts must include not only the contractor's name and address and a description of the scope of work, but several sections notifying consumers of various rights.

The HBA has put together an information packet with a check list of the law's key features, a copy of the law itself, and a sample law-complying contract. It costs \$25 for Massachusetts HBA members and \$35 for non-members. For a copy or for more information, contact the Home Builders Association of Massachusetts, 6 Beacon St., Suite 205, Boston, MA 02108. □

**Credit Crunch**, *continued*

Robert Fusari, president of Real Estate Service of Connecticut in Middletown, uses both joint ventures and treasury notes borrowed from a private investor as a credit enhancement to secure bank loans.

The problem with this type of arrangement is locating people willing to invest in your company. "It's hard to get into using investors if you aren't accustomed to it and if you don't have a track record," Fusari says. And once you find them, it takes some business finesse to arrange a deal that is mutually beneficial. Also, like banks, many investors are shying away from real estate these days.

Another alternative is to secure joint loans with the buyer. This gives you a better chance of getting the loan. But be prepared to submit a lot of paperwork to the bank. Also, getting loans this way

means you're at the mercy of the buyer, Nelson says. "If there's any dispute and the buyer refuses to sign over the draw, you're stuck."

With luck and a decent economic recovery, this small credit crunch for small builders shouldn't last long. Banks in many regions have already begun lending (some with considerable fanfare) to larger builders for new development, as part of an overall campaign to fund a recovery. Even in New England, which has seen record bank failures in the last two years, some major banks (including one, Bank of New England, that was only recently restructured after failing) have launched high-profile lending campaigns. If these spur a recovery strong enough to move the unsold inventory remaining from 1990, small builders may begin to find loan money more easily. □

## TAX TALK

### Deducting Both Business and Pleasure

by Irving L. Blackman

Combining business and pleasure seems to be a universal goal of business travelers. However, the IRS does not allow you to deduct non-business (personal vacation) expenses — usually.

The trick is to convert non-business travel days into business days. When you succeed, you get a deduction (or tax-free reimbursements from your company) for days on which no business is conducted. Here's the general rule: You can't deduct for non-business days that fall at either end of a business trip,

but you can deduct if the personal days are weekends or holidays sandwiched between business days.

Exactly how is this trick done? Just schedule your business trip so that the business days flank a weekend or a legal holiday.

Let's take an example. Henry has business in San Francisco that he wants to combine with a Labor Day weekend visit to a friend there. First, the wrong way: Henry does his business from Monday to Friday, then sees his friend for the three-day weekend and flies home. No deduction for the

weekend.

Now the right way: Henry schedules the five business days on either side of the three-day weekend. Because he began and ended his trip with business days, he can deduct lodging expenses and 80% of meal costs for the entire eight-day stay. Or he can receive a 100% reimbursement from his company and have his company take the deduction. □

*Irving L. Blackman, CPA, JD, is with Blackman Kallick Bartelstein, 300 S. Riverside Plaza, Chicago, IL 60606.*