

How to (Almost) Turn a Profit in Spec Remodeling

by Richard Cooley



The spec rehab of this 1,700-square-foot cape turned out to be a break-even proposition.

Like many contractors, I always keep a finger in real-estate speculation. Who knows better than a contractor how to enhance a property and thus increase its value? So last year, when I saw that work was going to be slow for the winter, I looked into investing in another property.

I've built new spec homes before, but since vacant lots weren't a good buy, I decided that wasn't the best plan of action. I've also invested in a multifamily building and rented out the apartments, but I didn't want to tie up money in a long-term investment. I wanted a quick in and out, and I wanted to limit my expenses to \$60,000 or less. I went over that in the end, but it was a place to start.

I consulted my realtor. He explained that in upstate New York, the only brisk activity in single-family home sales was at the entry level home, or, in certain locations, the real luxury homes. Since I didn't have the finances to play with luxury homes, we decided to find something that would appeal to the first-time homebuyer.

Shopping Around

The next trick was for my realtor to find something that was available cheap, but which after remodeling would sell for

\$90,000 to \$100,000. This proved to be a lesson for both of us. He'd find something and get excited, but I'd take one look at it and tell him renovations would put me over budget. After wasting my time looking at several properties, I coached him on what to look for.

I wanted a house that was structurally sound. I didn't want to get into jacking up the house to replace rotten sills or fix bulging basement walls. I also didn't want a sagging roof ridge or sloping inside floors. Basically I decided I wanted a newer house, no older than 30 years, that looked dismal enough inside to discourage even the most enthusiastic home handyman.

My realtor found two potentials, but the asking prices were too high. Still, I put in offers that I could justify, only to be rejected. Homeowners often take personal pride in their homes. They think that, since they live there, the house is worth more than others are. I negotiated with one couple (who had been sitting on their house for over a year) until we were only \$6,000 apart. They said they couldn't possibly go any lower because they had raised three children in the house. They couldn't understand why that didn't make it more valuable to everyone else.

Leaving Emotions Out of It

On a whim, I asked my realtor to scan the multiple listing book for houses that were being sold by a bank or a corporation that was relocating an employee. I thought if I could deal with someone who could talk numbers and didn't have a passionate attachment to the property, I could do better.

My realtor soon found a bank foreclosure that fit all our criteria. The asking price was \$65,000. I offered \$49,500 and got it. I was nervous that it was accepted without a counter offer, but though they may have accepted less, I was confident about that price.

It was a 1,700-square-foot 1968 cape with a raised roof in the rear. It had four bedrooms, two baths, an eat-in kitchen, a dining room, a living room, and an attached two-car garage. The lot was large and bordered a well-kept farm. Everything was original in the house except the windows, which had been replaced with vinyl inserts, and the furnace, which was fairly new. All the neighboring houses were well-kept and similar in style.

The drawbacks were that the house was built on a slab, part of the dining room slab was cracked and sinking, and the front screened porch was falling

Lesson learned: Choose a house that needs a facelift, not major surgery

Spec Remodel Expenses

Anticipated Construction Expenses

Strip masonite siding and reside with vinyl:	\$3,100
Strip and reroof, repair chimney, flashing, etc.:	1,800
Repair foundation under dining room:	800
Cut in and install sliding door off kitchen:	1,000
Build small deck:	600
Cut in and install bow window in dining room:	800
Replace interior doors (flush birch):	1,100
Replace two exterior doors:	500
Install, repair, and tape sheetrock:	600
Replace kitchen counter:	600
Replace bath sink and vanity, toilet, tub surround:	2,000
Repaint interior:	1,000
Misc. insulation, trim, light fixtures, etc.:	400
Floor coverings:	1,500
Drill new well, install pump and new pressure tank:	3,800
Heating oil and electricity used during job:	600
Dumpsters:	1,200
Subtotal:	\$21,400

Construction Expenses Discovered In Progress

New footing and foundation under one side of garage:	\$800
New septic tank, move leach field:	1,500
Landscaping:	400
Subtotal:	\$2,700

Total Construction Expenses: \$24,100

Direct Business Expenses

Legal, accounting, insurance:	\$1,500
Realtor commission:	4,750
Loan interest:	2,000
Total Direct Business Expenses:	\$8,250

The Bottom Line

Sale price:	\$95,000
Construction expenses:	-24,100
Direct business expenses:	-8,250
Original purchase price:	-49,500
Gross Profit:	\$13,150
Less overhead (11 weeks at \$400/week):	-4,400
Less salary (11 weeks at \$800/week):	-8,800
Loss:	-\$50

I could have done worse, considering the risk. On the other hand, I wasn't thrilled with the reasons I failed to make a profit. Particularly aggravating were the \$2,700 in unforeseen, but foreseeable, construction expenses — the new footings and foundation, the new septic tank, and landscaping. A closer look at the place would have turned these up. But since I had been evaluating and bidding on several properties to get just one, I had carefully budgeted the time I spent assessing them. In this case, I slightly underassessed, and it cost me.

The One That Got Away

I also had the misfortune of letting an early \$99,500 offer get away from me. Two parties made full price offers the first week the house was on the market; I chose the wrong one, against the realtor's advice. The people I accepted backed out three days later, as was their right under New York state law. I heard they tossed tarot cards and saw it was a bad time to invest. Seriously. At least they had some reason; in New York and many other states, you don't need a reason to back out in those first three days.

When we went back to the other party they had already committed themselves to another house. So I had to hold the house for another two months and sell it for \$4,500 less. I also had to pay \$2,000 in interest and \$1,000 for maintenance during that period. Thus, the missed offer cost me a total of \$7,500. I still joke about it — it just wasn't in the cards.

Next Time

The lessons I learned were numerous and may be as valuable as the money made.

I was fortunate to find a hard-working realtor willing to work for a 5% commission. It was against his advice that I accepted the offer that went bad. He told me he thought the other party was a more solid offer, despite looking the same on paper. Next time I'll go with his instincts.

One problem was that this house didn't have a large master bedroom. If I were to do it again, I would convert the four bedrooms into three, making the master bedroom as large as possible, with bigger windows and more closet space. The house would have sold faster that way, even priced to cover the extra expense. One good move I made was to add a bow window in the dining room and a sliding door off the kitchen. A bright house sells well.

I've since invested in a bigger house (at twice the budget) that I'm now renovating. The project is going well and it looks like I'll do better this time — as long as the cards fall my way. ■

Richard Cooley is a builder/remodeler in Schenectady, N.Y.

down. Also, the place was dark and dismal. It hadn't been occupied for at least six months. The carpet was ripped up, and vandals had sprayed messages on the walls. The house also needed a new well and an exterior overhaul.

The table shows the cost of various repairs, which came to \$24,100, \$2,700 (11.2%) of which I failed to anticipate. These numbers reflect only my direct labor and material costs. If they seem a bit lower than you'd expect for contract work, it's because there was no homeowner involved, so all decisions were made quickly, without haggling over prices or alternatives.

On top of the repair costs were direct business costs of \$8,250, bringing the total direct cost of doing the job to \$32,350. Added to the \$49,500 sale price, that comes to a total direct cost of \$81,850. Subtracted from the sale price of

\$95,000, that left \$13,150 to cover my overhead, salary, and profit.

What was in it for me. Though I worked on other jobs during the course of this project, I spent the equivalent of about 11 weeks actually working on this job. That comes to about \$1,200 per week gross profit (\$13,150 ÷ 11 = \$1,195.45).

My company's overhead at this point — insurance, telephone, equipment, and so on — was about \$400 per week, and I try to pay myself a gross salary of about \$800 per week. Thus my target gross profit per week is about \$1,200. I like to hit between there and \$1,500 so I can have some profit to reinvest in equipment or save for a rainy day. So in the end, I almost broke even on this spec rehab. As it turned out, the \$1195 per week paid for all but \$50 of my overhead and salary; so I fell one nice dinner short of breaking even.