

The Fixed Price Advantage:

How Builders Are Responding to Today's Affluent Homebuyers' New Financial Realities.

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The Great Recession

It's been a challenging five years for homebuilders since the full force of the so-called Great Recession. Many of those who hung on during the bleakest of times are seeing a promising resurgence in the high-end segment. But today's affluent buyer isn't the freewheeling big spender of the 2000s. The smartest builders are listening to the customer's needs and changing the way they do business.

The Great Recession that began in late 2008 fundamentally changed the way Americans approached saving and spending money. During the '90s and first few years of the new millennium, there was an almost unbridled sense of optimism among middle- and upper-income segments. However, with the downsizing of workforces, stagnation in wages, declining home values and historically low savings interest rates brought about by the recession, most households in the U.S. did an about-face in their established spending patterns.

Among baby boomers, the demographic segment fueling a large part of the growth of the luxury home market, the prolonged impact of the recession hit particularly hard. According to a study by the financial services company Ameriprise, as reported by Fox Business in April 2012, just 17% of boomers were feeling confident about their financial future, as compared to 39% in 2007. Boomers, the story concluded, were not at all confident in their ability to provide for themselves and their families.¹

Although the so-called "Silent Generation" (born 1925 - 1945) were more disciplined about sensible living, the impact of near zero interest rates, volatile markets and rapidly escalating healthcare costs had a severe impact on the wealth available in their retirement years. As certified public accountant Ernest Almonte noted, their economic circumstances had a profound impact "because all the generations are tied together - parents provide for children, children provide for parents, and inheritances are passed from one generation to another."²



A New Attitude Among Affluent Americans

Signs of a turnaround began to emerge in 2012, particularly among affluent Americans. In a story titled, “Shifting Attitudes of Luxury Home Buyers; How Have Consumer Habits Changed?” Frank Petras notes, “by 2011, demand for luxury homes had risen again. In short, the post-recession affluent shifted into a home shopping mode. We have seen the results of new demand in 2012. Many markets have seen a rise in luxury home purchases (and in some cases, rising prices as well).”³

According to Petras, the lessons learned from the recession of 2008 - 2012 brought about a distinct new attitude among the affluent class in the U.S. Among many observations, he notes:

- Quality over quantity; bling is out, artisanship is in.
- Demand for bigger has shifted to a demand for better.
- Affluent people want to be considered successful, not wealthy.
- In lieu of “things,” people enjoy experiences that make their lives more meaningful.
- Affluent people believe they have earned and deserve the things they have.

For residential builders and other organizations marketing to the affluent segment, responding to this shift in attitudes was critical. Respected business journalist Jim Jubak, in his article “How the Great Recession Changed Us,” wrote that for brands, “the effort right now is to find the right value proposition - and that means, so far, possible success for businesses that charge more, but also deliver what is perceived as higher quality at the right price.”⁴



Adjusting to a More Engaged Home Buyer

For the majority of builders engaged in the construction of high-end homes, surviving the past five years of economic contraction has forced them to rethink every aspect of their business. Getting realigned with the new values of the affluent home buyer continues to be critically important in re-establishing a sustainable business in home construction.

The shift in attitudes among affluent home buyers has become very apparent to Jeff Viney, president of Meritus Signature Homes. Based in Anderson, SC, Meritus has been building high-end homes around Upstate South Carolina's pristine mountain lakes since 2005.

"Today's affluent customer is very different," says Viney. "They ask more questions and want a lot more details. They're more engaged in every step of the building process. It actually makes it a more fulfilling experience for both the buyer and the builder."

For Viney, who worked for years in building products before moving into home construction, a more involved and informed client is the foundation of a lasting relationship.

"I've touched all aspects of the industry," he says. "As a result, I have a better understanding than many builders about construction products. I've sold them; I've worked for the manufacturers; I know how they go together. It's easy to educate our clients when you've been hands-on with the building blocks of our industry."



Construction Cost Approaches: Cost-Plus versus Fixed Price

Viney and his partner, Andy Atkins, had a choice years ago in how they priced the construction of a new home. Across the industry, the two most common approaches are cost-plus and fixed price.

Simply stated, cost-plus means that the builder bills the client for all direct costs associated with building the home and then adds a fixed percentage to cover the builder's overhead and profit margin. Across the U.S., the cost-plus approach is more preferred by custom homebuilders.

The downside of the cost-plus method, according to construction industry legal specialists Peckar & Abramson (www.pecklaw.com), is that construction costs are often not capped, and therefore the owner typically is liable for open-ended construction costs. "The contractor may have little incentive to reduce costs on the project because the owner is obligated to pay the contractor for all the costs of construction. In fact, in a cost-plus arrangement with a percentage-based fee, the contractor will earn a greater fee if construction costs increase because the contractor's fee increases in proportion to the higher costs of construction."

Indeed, the problem from Viney and Atkins' perspective was that this arrangement didn't provide a very strong incentive for the builder to work on the client's behalf to secure the best pricing for construction products. In fact, the cost-plus approach actually creates a kind of disincentive for the builder. For instance, if the price of lumber goes up during the building process, the client has to absorb the difference while the builder pockets the added margin.

The fixed price arrangement simply means the total price of a home is set in advance and will not be changed due to increases or decreases in the actual costs within the scope of the contract. For Meritus, which places a high value on integrity and doing what's right for the customer, this was unquestionably the better way to go because of the way it protects the client.



Protecting the Client

The fixed price approach is much more challenging for builders because they're making a firm commitment to deliver that new home for a set price. To make it work requires high attention to detail, communicating clearly with the client and establishing strong relationships with materials suppliers. This level of detail management is time-consuming, but it results in a clear understanding between builders and their clients.

"Our clients know exactly what they're getting on the front end, down to the two-by-fours we're using," says Viney. "They don't need to worry about whether the lumber market has gone up or if there's a sheet rock shortage. They get to enjoy the homebuilding process for what it is and not worry about all the other headaches. That's our job."

Naturally, the price of building products can rise at any time, occasionally hitting after the pricing is figured. Viney stays in touch with his suppliers to minimize the impact of a cost-of-materials increase by adjusting his purchasing sequence or negotiating a better price.

"I'll give you a real-world example," says Viney. "We just had an increase on a cabinet line of 13.9 percent. A cost-plus builder working on a standard mark-up would have just made 15 percent more on the price increase. At Meritus, we called our supplier and negotiated to hold our existing price for 60 more days. That's how we negotiate to protect our client and ourselves."



Communication and the Client-Focused Homebuilder

Like many homebuilders that survived the Great Recession, Meritus continues to respond to the needs of today's affluent consumer. At the Meritus Design Center, customers see an expansive offering of cabinetry styles, countertops, windows, hardware and plumbing fixtures in comfortable room vignettes. This is also the ideal venue to discuss every aspect of the building process in detail. It's the perfect solution for the time-challenged home buyer who wants a higher level of engagement in the construction process.

"It all goes back to understanding what people want and communicating effectively with our clients," Viney concludes. "This whole process is about educating people so they can make smart decisions, whether you build with us or not."

It's been a long road back for custom homebuilders. Many were forced to close their businesses. Among those builders that survived, the pervasive sense of gloom was finally lifted in the summer of 2013, when for the first time in seven years, the "Builder Sentiment Index," as measured by the National Association of Home Builders, rose above 50.

A gradually improving economy continues to buoy the outlook among builders. But those likely to seize the opportunity are the ones responding to the new realities among their target customer base. Like Meritus Signature Homes, they have had to shift their business processes to accommodate today's more engaged and value-conscious affluent home buyer. For those who can continue to make this transition to a more client-focused operation, there appears to be tremendous opportunity for sustained growth.



References

¹ Andrea Murad: How the Great Recession Changed Generations' Money Views. Published April 26, 2012. <http://www.foxbusiness.com/personal-finance/2012/04/26/how-great-recession-changed-generations-money-views/>

² Ibid.

³ Frank Petras: Shifting Attitudes of Luxury Home Buyers; How Have Consumer Habits Changed? January 16, 2013. <http://www.frankpetras.com/blog/2013/01/shifting-attitudes-of-luxury-home-buyers-how-have-consumer-habits-changed/>

⁴ Jim Jubak: How The Great Recession Changed Us. Published June 11, 2012. <http://money.msn.com/investing/how-the-great-recession-changed-us-jubak.aspx>

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