

Eight-Penny News



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Congress weighs new rules for FHA

The U.S. Congress is considering this fall two new sets of Federal Housing Administration lending guidelines—one from the Senate, one from the House—to save the FHA from bankruptcy. Some observers say the Senate plan would cut as many as 100,000 potential borrowers out of the home market.

FHA loans are among most flexible and lowest-cost available. You do not have to be a first-time buyer, and there are no income, age, or sales price limits—the only thing limited is how much you can borrow from FHA: 95% of the area median sales price, with a ceiling of \$124,875. You can, for instance, borrow up to \$124,875 as part of financing for a more expensive house, securing costlier financing as necessary for the rest of the payment.

The best feature of FHA loans is that they require low up-front costs. Down payments must be only 3% on the first \$25,000 and 5% on the remainder, and the

required 3.8% insurance premium fee can be financed as part of the mortgage note. These low up-front costs have made loans available to tens of thousands of borrowers who couldn't qualify for loans elsewhere.

But too many loan defaults, many on overvalued loans, have caused heavy losses. A 1990 Price-Waterhouse audit found that the FHA's mortgage insurance would lose from \$200 million to \$500 million in 1990, and that accelerating losses in following years would bankrupt the fund by the late 1990s.

The two congressional plans seek to avoid this. The Senate plan, which rose primarily from proposals by Sen. Alphonse D'Amato (R-N.Y.) and HUD secretary Jack Kemp, would raise the cost of borrowing for higher-risk borrowers by charging them insurance premiums up to 6.6% and making those premiums payable up-front. This would raise up-front costs by several thousand dollars. Critics such as Jay Shaddock of the National Association of Homebuilders (NAHB) say that would cut as many as 100,000 would-be buyers out of the mortgage market.

As an alternative, the NAHB and many affordable housing groups are backing the House FHA plan, sponsored by Repre-

sentatives Bruce Vento and Thomas Ridge. This plan charges the same insurance premiums to all borrowers: 1.35% of the mortgage, which may be amortized over the mortgage's full term, plus .6% yearly on all loans; this last amount could be raised as much as .5% at a time by the HUD secretary as necessary to keep the fund solvent, subject to congressional approval. The 1.35% up-front premium can be borrowed as part of the mortgage as long as the total loan value doesn't exceed the property's. By spreading the premiums over the life of the loan, the Vento-Ridge plan would keep up-front costs at or below their former level.

"Price-Waterhouse has found both plans to be valid ways to maintain the solvency of the fund," says NAHB's Shaddock. "The Vento-Ridge amendment would charge everybody a little more instead of hitting those borrowers most in need of the FHA's help."

A joint House-Senate committee will decide this fall how to work out the differences between the two bills, so that one can be included as part of this year's omnibus housing bill. In the meantime, NAHB is urging builders to write their senators and representatives in support of the House plan. ■

N.E. credit crunch squeezes builders

If anyone would seem a good credit risk, it would be Dan Martin, a custom builder in Bedford, N.H., who sold over \$4 million in homes in 1989 while keeping debts down. This year has been as lucrative.

Despite the good track record, Martin said he felt like a deadbeat looking for a used car loan recently when he shopped for a construction loan to build a custom home for a fully financed client. In fact, he had to go to six banks to get the loan.

"Our regular bank had gone belly-up, so we had to establish ourselves anew. It was as if we were just starting business—they wanted all the personal financials, every building plan, spec, and permit—just being incredibly thorough about it," he said.

But the frustrating part was that even when all the requirements were met, many of the banks still turned him down.

"It is, without a doubt, one of the most frustrating things I've had to deal with," he said.

Martin is not alone. Bankers, builders, and industry analysts may differ on who's to blame and whether the situation is justified, but one thing is clear: construction lending in New England is extremely tight.

The roots of the problem lie in the lending frenzy New England banks indulged in during the mid-

1980s. "Banks were just throwing money at the building industry five years ago, and they made some very imprudent loans," says industry analyst Robert Sennott. Many of those loans went bad.

As a result, says Sennott, Massachusetts alone has seen five banks taken over by the Federal Depository Insurance Corporation (FDIC). Other banks, including some of New England's largest, have suffered record losses.

These failures and losses, along with the increased federal regulatory scrutiny they have brought, are producing an atmosphere of caution at banks.

Not surprisingly, that caution gets directed at construction loans, which, along with bad mortgages, were the source of many of the banks' losses. Loans that once would have sailed through the application process now move slowly.

Even air-tight loan prospects sometimes get shot down. Scott Pollock, a real estate agent and development specialist with HABS Inc. in Bedford, N.H., says that even bankers are frustrated by the situation.

"I know a lot of bankers who are honestly trying to make loans. But the loans get to a certain level [in the bank's bureaucracy], and they get thrown out. It might go all the way from the original loan officer to the president, getting

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Montana builder plans "scrap" house

"I can't stand waste," says Montana builder Steve Loken. "It drives me nuts."

For many years, Steve Loken indulged his waste-hate by building energy-efficient houses. His efforts won him a spot as the principal trainer for builders in the Bonneville Power Administration Good Cents Homes program, and national notoriety as a seminar leader and innovative builder.

Not long ago, however, Loken began to worry as much about wasted wood chips as wasted kilowatts. The increasing timber supply problem in his region—layoffs at timber mills, escalating lumber prices, and a shrinking timber stock—have him striving to reduce the amount of resources used in building houses. Toward

that end, he founded the Center for Resourceful Building Technology (P.O. Box 3413, Missoula, MT 59806; 406/549-7678). The goal of the Center, says Loken, is to "foster efficient energy and resource use in the building industry by accelerating the application of innovative recycled or conserving materials."

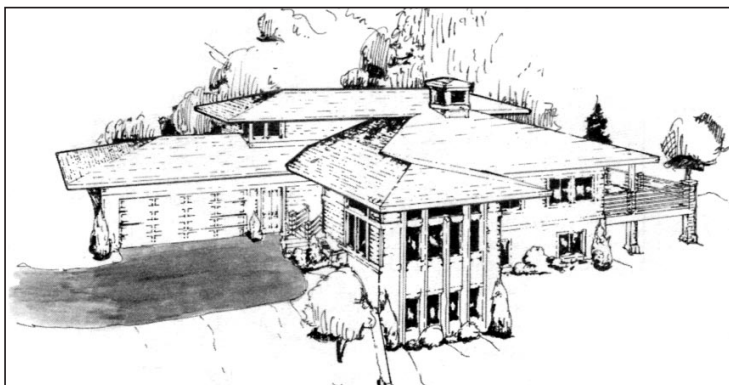
The Center's first project is "ReCraft Home 90"—more casually known as the Scrap-Tech House. Loken hopes to use the 2,400-square-foot house (see illustration) to show that resource-efficient building materials and techniques already exist. The house will not only be resource-efficient in its operation (using the latest in tight-house construction and water and energy-conserving

appliances and fixtures), but will be made of materials that use resources as efficiently as possible.

The list of innovative materials is long. Along with commonly known resource-efficient products such as Parallam rafters, concrete reinforced with fly ash, and particleboard sheathing, the house will use such lesser-known products as fiber-reinforced cementitious lap siding; structural stress-skin floor decks with cores of honeycombed cardboard; and "pole-joist" I-beams, which frame small lodge-pole pines (which grow in abundance in the Rockies but make poor dimensional lumber) on either side of I's made of waste wood chips. Very little unprocessed wood will be used, and virtually no dimensional framing lumber.

Loken is not alone in seeking

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"ReCraft Home 90" is the first project for the Center for Resourceful Building Technology.

Workers comp scofflaws targeted by Conn. law

A recently enacted Connecticut law is expected to blunt the competitive edge gained in bidding by companies who do not pay a fair share of workers compensation and unemployment insurance.

The law permits builders to sue other builders who are not paying workers compensation and use that reduced cost as way of lowering bids. Previously, only the state and employees could sue an employer who cheated on workers compensation insurance and other benefits.

The edge gained by not complying with the benefit law can amount to a 20%-25% reduction in labor costs depending on the state, according to Jim Lohr, director of the Carpentry Industry Partnership. The partnership includes members from labor and management and is dedicated to promoting the construction industry in western Connecticut. "As far as I know, Connecticut is the first state to have such law," Lohr said.

The most common way contractors skirt the law is by falsely representing employees as subcontractors, Lohr said. According to the Internal Revenue Service, 38% of all employers are misclas-

sifying workers as subcontractors. But few employees being misclassified sue their employers. Some are willing participants of the scheme, while others fear for their jobs.

Builder Michael Hobbs, president of Hobbs Inc. in New Canaan, said that the intention of the law is not to incite a number of frivolous lawsuits, but to make people adhere to the existing laws.

"When a lawsuit is filed, the trouble will not go away when it is resolved," Hobbs said.

The contractor who has been sued will become known to the government agencies responsible for enforcing the law. Those agencies may then pay closer attention to the offender's business, Hobbs said.

"Hopefully people will get the message that not operating in a legitimate manner is more trouble than it is worth," he said. Hobbs admitted that accumulating official evidence to justify a lawsuit may be easier said than done, but he added that the information is available.

"It's a small world. At least in this area, people know who is doing what," he said. ■

"Scrap" house, continued from previous page

alternatives to resource-intensive building materials and techniques. Another builder-initiated effort is the "Tennessee Initiative" launched by ex-contractor Charles Howell, which aims to increase awareness of alternatives to what the Initiative calls "environmentally insensitive" materials (for information, contact Trust for the Future, 2704 12th Avenue South, Nashville, TN 37204; 615/297-2269). And some Forest Service employees, such as Dean Graham of the Service's Missoula office, are working to encourage the development of products that will take less of a toll on the nation's forests while re-employing laid-off timber workers.

"We think there's a whole future in the kinds of products Steve is using in his new home," says Graham. "If we can encourage manufacture of that material, it can be both a partial solution for some of our environmental problems, and an employment source for displaced timber workers." One Montana sawmill has already retooled to make the type of pole-joists Loken is using in the ReCraft project.

Loken hopes to finish the house in summer of 1991. For the time being, though, he's glad to be taking a practical step toward solving the timber supply problem. "Every carpenter I've talked to is aware of the [problem]," he says.

"But most of us have kept our heads to the sawhorses and tried not to think about it. But I finally had to do something when I looked up and realized, Whoa—there's the end of the woods."

—David Dobbs

NE Credit, continued from previous page

yeses all the way, and get a no from the board. And this might be after 6 months."

One explanation for such seemingly arbitrary denials is the higher capitalization ratio—the ratio of capital (deposits on hand) to assets (outstanding loans)—being required by the FDIC. In the 1980s, banks needed 6 cents in deposits on hand for every dollar they lent—a 6% ratio. But new regulations have raised the required capitalization ratio to 8%. To reach that ratio, banks need either to increase deposits—difficult right now—or pare down their loan portfolios.

Builder Dan Martin ran into that explanation several times when being denied loans.

"The common response was that the house looks great, the numbers look great, the deal looks great, but we don't have the capital right now to do this," he says.

With some banks unable to make loans even for solid projects, builders need to anticipate and account for the situation.

To begin with, banks will likely require:

- A sure buyer with solid financing of his/her own. As builder Martin puts it, "Banks want a pre-sold unit with a qualified buyer."
- Air-tight documentation. Or, as Scott Pollock puts it, "be ready to show your underwear." Banks will want to see thorough documentation not only of the builder's own financial status, but possibly that of the buyer as well. They will also want complete information about the project to assure them they aren't lending too much money on it.

- A low loan-to-value ratio. Even two years ago, banks were lending builders as much as 80% of the expected sale value of a project. Now the usual loan-to-value ratio allowed is 65%, and that will likely be based on construction cost rather than sale value. That means a more than 75% increase in the amount of money the builder must kick in.

In addition, loan applications will take longer—up to 6 months. Because of these delays and the possibility of denial even on solid prospects, builders may want to apply to more than one bank at a time.

If all this seems a tough row to hoe, builders can seek comfort in the idea that, at least for the banks, the caution is healthy, and a reasonable reaction to the economy's warning signals, not to mention federal banking requirements.

Some claim it is also healthy, in a Darwinian sense, for the building industry. "This should result in a cleansing of some of the marginal players," says Sennott. Most of the seasoned, veteran builders aren't having too hard a time getting loans. The people who were conservative with their cash during the boom periods can still borrow." Of course, responsible builders having trouble getting loans would argue otherwise.

When the tight credit will end is anybody's guess. But it won't likely be before the current recession ends, New England's housing surplus is sold off, and New England banks start regularly turning profits again. Until then, the best strategy will be to apply for any construction loan early, thoroughly, and to multiple lenders.

—David Dobbs

OSHA toughens enforcement of trenching standard

The Occupational Health and Safety Administration (OSHA) is stepping up enforcement of its new trenching standard, which took effect in January.

"We have a new trenching emphasis program," says Rob Medlock of the Peoria, Ill., OSHA regional office. "Our inspectors are told to stop and investigate excavations over 5 feet deep. We have the authority to stop the job immediately, and we can impose a \$10,000 penalty for intentional disregard."

OSHA expects the improved trenching safety measures to reduce the annual toll of 75 deaths and 3,000 injuries caused in trenching accidents.

While much of the standard covers conditions more likely to occur on commercial jobs, the law also applies to residential sites. The two instances where the standard is most likely to apply are in foundation excavation and in sewer trenching.

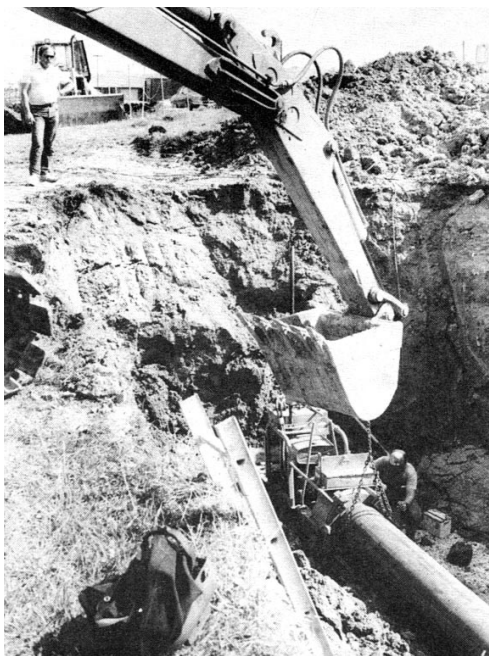
When a contractor uses foundation forms or lays concrete block, workers may be between the forms and the side of the

excavation. To protect these workers, the OSHA standard requires a 34-degree slope on the excavation. As a rule of thumb, slope the excavation back 1 1/2 feet for every 1 foot of depth. If the excavation goes down 10 feet, excavate back 15 feet from the lowest point.

The OSHA standard also applies to sewer trenching. A sewer running out to the main may need to go down 8, 10, or 12 feet. The same slope requirements apply.

An exception to the general rule are projects supervised by a registered professional engineer, and having a Type A (cohesive) soil, which only needs to slope back nine inches to every foot. But if you're not testing the soil, you need to slope the soil at a 34-degree angle.

For a copy of the excavation and trenching standards, contact your local OSHA office. Many OSHA offices are conducting training sessions for contractors. Or, you can call the Washington office to obtain a local number (202/523-8151.) ■



OSHA plans to look more carefully at trenching practices on large and small construction sites.

From What We Gather

Toxics-contaminated soil may be the raw material of the future for building blocks, roof tiles, pipes, or other construction materials. A patented process called Detox devised by Dunston Ceramics in England can turn the dirty dirt into a glass-like, inert material that can be manipulated into many shapes and densities. Right now, however, the process costs 50% more than simply burying the contaminated soil, a conventional disposal method.

Historic preservationists may have to answer to an even higher authority than the

Internal Revenue Service when it comes to designating churches as landmarks. In at least two suits, church officials in Washington, D.C., and New York, have fought the historic landmark designation for their churches. Financially strapped clergy prefer keeping open the option of selling the often valuable downtown church land to turning the spiritual shrine into an architectural one.

Four days pay or 5% of gross monthly wages was requested from timber industry workers in California to fight an environmentalists' initiative to ban

clearcutting and save some old-growth redwood by the timber industry, which does \$2 billion annually in sales.

Frameless or European-style cabinets long considered stepchildren of the U.S. kitchen cabinet industry are on the road to becoming blood relatives. More than half of the large cabinet companies (\$15 million plus in sales) polled in a recent national survey now make frameless cabinets. And national sales have gone from \$225 million in 1987 to \$312 million in 1989. ■

White House renovations quite a royal pane

If you're looking for a plush renovation contract, maybe you should look in D.C. The White House recently asked Congress for a \$7.86 million operating budget for fiscal 1991—an 18% increase over last year. While most of this will go into the fixed maintenance expenses that go along with maintaining presidential appearances, much of it will be spent on home improvements.

According to a recent *Washington Post* article, the improvements include \$500,000 to update and expand the kitchen; \$125,000 to renovate antique furniture; and (if you're standing, sit down) \$800,000 to replace broken window panes.

Apparently 800 panes need immediate replacement, and another 700 will need to be replaced during the next 15 to 20 years. That's \$533.33 a pane. The replacement is so expensive, we are told, because the panes must be custom-made—possibly in France—to match the existing ones, many of which date from the 19th century.

The kitchen, which hasn't been renovated for 40 years, would be enlarged to make room for, among other things, a pastry center to make tasties for the sweet tooth of the White House's guests. No word on whether the kitchen includes a broccoli center. ■

New Hampshire university offers energy videos

The University of New Hampshire Cooperative Extension Service has a new set of energy conservation videos that it will lend free to any New Hampshire citizen.

The 19 tapes present 18 different programs, ranging from "Radon Control and New Home Construction" to "How to Insulate Cathedral Ceilings."

The tapes were originally developed at Oregon State University, then adapted for New Hampshire. Some, such as those on energy-efficient windows or insulating attics, apply to remodeling as well as new construction. For information, call Faye Plowman at 603/862-2512. ■

Tax Talk

Tax law proposals may hurt switch to S corporation

By Irving L. Blackman

Are you an S corporation? Relax. Nothing in this article can hurt you. But if you are a C Corporation (a regular tax-paying corporation), look out. You may get hit with a new tax tornado.

The Ways and Means Committee and the Joint Committee on Taxation are considering "tax simplification" proposals. One of the proposals involves electing S corporation status. What would happen if your C corporation was converted to an S corporation? The conversion would be treated just like a liquidation of the C corporation. First, the corporation would get socked with a tax just as if it had sold all of its property at its fair market value. You, the stockholder, would be hit with a second tax based on the value of the corporation in excess of your tax basis (usually what you paid for the stock). The practical effect of the this proposed law would be to prevent almost any C corporation that had substantially increased in value from ever electing S corporation status.

For instance, your C corporation owns real estate that has a book value of \$200,000—but it is worth \$530,000. You elect S corporation status. The built-

up gain of \$330,000 is immediately subject to tax, which amounts to about \$130,000 including state taxes. That means you get \$400,000 in value in the "pretend" liquidation of the C corporation. You will have to pay an additional \$120,000 in personal taxes.

The practical answer is that you would never elect S corporation status under those circumstances. And that is only one simple example of the proposed law in action.

Talk to your tax adviser as soon as possible and have him or her pencil out how this new law could affect you in dollars. If in doubt, file the S election with the IRS as soon as possible. You have nothing to lose. The S corporation can be revoked at any time.

For more information, send for special reports, *How to Take Money Out of Your Closely Held Corporation* and *A New Tax Superstar S Corporation*. They cost \$25 each or \$39 for both. Contact the Book Division, Blackman Kallick Bartelstein, 300 South Riverside Plaza, Chicago, IL, 60606.

Irving Blackman, CPA., J.D., is with Blackman Kallick Bartelstein, 300 South Riverside Plaza, Chicago IL 60606.

Build a powerful personal computer at home with the video titled, "Step-by-Step PC Computer Assembly." The two-hour video provides detailed instructions on how to turn a pile of components into a computer. JVF Distributors, Box 154, San Geronimo, CA 94963.

New SummaSketch II graphics tablet features a 16-button cursor and several other improvements for architects and engineers. Summagraphics Corp., Sixty Silvermine Road, Seymour, CT 06483-3907. 203/881-5400.

Shearwall analysis program, STMFR, performs analysis of buildings with frames and shearwalls under lateral and vertical force. Portland Cement Association, 5420 Old Orchard Road, Skokie, IL, 60077-1083. 708/966-6200.

Builder's CAD by Integrated Computer Graphics promises to be specifically for builders with the ability to catch design errors; automatically generate roofs, elevations, and perspectives; and generate cost reports. Integrated Computer Graphics Inc., 1120 Hope Road, Suite 100, Atlanta, GA 30350. 404/552-8800.

Computer Bytes:

