

## Keystone Realty

Keystone Realty and Homebuilders was founded in 1995 in Augusta, Georgia and has grown from one neighborhood to twelve today. The company is effectively managed by Rhonda Banks, who is a graduate of ASU and has an MBA from Georgia Southern. Her generosity towards students is well known and she was able to show this student the step by step process involved in the building and sale of a home, beginning with the purchase of land and the follow-up to the sale of the home.

The first step involved in the building of a neighborhood is to purchase the land. Land is the *raw material* that begins the process and its price fluctuates depending on the market value at any given time. It was revealed that not all of Keystone's land purchases result in housing, but some is sold if the company changes its development plans and the *opportunity cost* is too great. It takes a full two years to turn raw land into lots. Until then, this land is a *liability* and taxes must be paid yearly, which is a *fixed cost*. When the company decides to build on the land they must apply for permits from the local city and county. Keystone builds in Augusta, GA and in Aiken, SC and the permits required are Sewer/Septic permits and water permits. In order to apply for these permits the company must have site plans and blueprints drawn up and pay fees. The permits (an *explicit cost*) can run between \$207 all the way up to \$1,000 and take between two and four weeks to acquire. Sometimes, the city or county forces Keystone to combine lots for drainage reasons and this causes Keystone to reappraise its earnings estimates. However, to cut costs with landscaping and concrete in the laying of driveways, Keystone keeps the houses at the baseline, which is the permissible distance between the house and the curb.

Keystone operates its own mortgage company and Keystone sales agents may refer potential clients to its mortgage company. However, potential homebuyers can shop around and go with the company that gives them the lowest rate. Beginning in 2007 Keystone began to offer its clients a \$2,500 incentive to go with their mortgage company. The mortgage broker is Rhonda Lynn and she revealed that with the tightening of the underwriting guidelines that have been put in place it isn't worth her time to even look at a loan package until all of the documents have been assembled. A typical file is around four inches thick and even more documents are required for government loans. In order to qualify for a loan the purchaser must have at least a 640 credit score, though a 680 score is required for a conventional loan with six months living expenses in cash savings. The total debt to income ratio is 40/60 and this factors in the mortgage payment. Beginning in January of next year the FHA is going to increase the down payment from 3% to 3.5% in order to purchase a home.

Ms. Lynn revealed that two macroeconomic issues directly influence the course of her business. It's her belief that as the stock market improves that interest rates will increase and that since China owns so much of our nation's debt the value of the dollar may decline. What she is referring to in the first instance is the *market for loanable funds* which combines the markets for stocks, bonds, mutual funds etc. and this interaction of borrowers and lenders determines the market interest rate and the quantity of loanable funds. The supply of loanable funds is determined by the amount of saving or dissaving by the government and households. So, another factor to consider is the budget deficit currently being run by the government which reduces total savings in the economy. The purchase of US government bonds by China and other nations may result in an increase in foreign imports that reduces the growth of domestic GDP, which would most likely lead to even more government spending to bolster the economy and *crowd out* investment spending as a result of more government spending. For the time being, the government is offering a tax credit of \$8,000 for first time homebuyers and a \$6,500 credit for existing homeowners who have been in their present home for 5 of the last 8 years. However, the client must be under contract by April 30 and the sale must close by June 30. It isn't known if the government will extend this opportunity.

The next step is for the client to choose a floor plan and if they want they can add distinctive lighting fixtures, flooring etc. This is an extra cost to the client. As a matter of fact, Keystone decided to add its own design studio because overages from other vendors were taking away profits. This is an example of *Comparative Advantage*, which is the ability of a firm, individual or even a country to produce a good or service at a lower opportunity cost than its competitors. Through trial and error, Keystone has found it's wise to insist that clients pay a certain amount up front for any special additions they wish to make to the home. They may also build into any empty space if they want if the space is heated. It only costs @ \$8,000 to add a 320 sq. foot room at @ \$24 per sq. foot. It was explained that it's cheaper because the space is already there and is unused. Indeed, the floor plan gets less expensive to build because the materials used have been estimated and noted. This is a perfect example of *Marginal Cost*, which is the change in a firm's total cost from producing one more unit of a good or service (in this case an additional room).

Next, the client meets with the builder. This meeting is good for certain personality types, esp. analytical types, who may cause trouble later on if potential problems aren't smoked out at this stage. Clients again meet with the builder during the pre-drywall phase as the house is being built. As the house is nearing completion the clients are shown how to operate the house from the electrical breakers to the ovens. Of interest here is the fact that Keystone has implemented a bonus program for the builders to build faster. This gives the builder an

*incentive* to finish on time. However, this can sometimes have a negative effect if a builder doesn't want to work on a house that has a different floor plan than the one he may already be engaged in building elsewhere and the differences may make him alter his plans. The builder at this stage must weigh his incentive and engage in a *trade-off*, but on the whole the incentive plan has been found to work out best for Keystone. This is important because Keystone wants the home built and the contract closed in 4 months.

When the parties are ready to close they use an attorney who has an office in the complex with Keystone. Keystone decided to use this attorney because too many man-hours were spent going back and forth using a courier and this added greatly to expenses. This expense would have previously been shown on Keystone's accounting sheets as part of its *Accounting profit*, but reducing it has added to Keystones *Economic profit*.

At its most productive Keystone had around 50 employees and built 307 houses in 2007. As the market tightened only 175 houses were built in 2008, but went up again in 2009 to 210. This year they are projected to build 230 homes and have a full time workforce of 32 people. The technology of home building hasn't changed much, but Keystone has found ways of working around this by adding the design studio, the on-site mortgage broker and attorney, and implementing the incentive plan. All of these innovations show strategic planning and a willingness to adapt to market demands to stay ahead of the curve. After the sale a gift basket is delivered to the new homeowners and a follow-up visit is made again after 10 months. This is designed to enhance the clients *Utility*, which is the enjoyment or satisfaction that people receive from consuming goods and services. This may help with referrals, but it also shows the customer service values and detail of Keystone. Due to this innovating spirit and attention to detail from the purchase of the raw material to the utility of the homeowner, Keystone will be in business for many years to come.