

# Bloomberg

## Homebuilders Revive Stalled U.S. Projects as Banks Unload Lots

*By Prashant Gopal and John Gittelsohn - Sep 7, 2010 9:01 PM PT*

Construction crews are returning to the Cascades of Groveland, a gated 55-and-older community west of Orlando, Florida, almost three years after its bankrupt developer left owners of the existing 238 houses surrounded by empty lots, partially built homes, and an unfinished clubhouse.

Shea Homes, a builder based in Walnut, California, bought the remaining 761 lots from Bank of America Corp. in June and reopened the project Aug. 25 with a new sales office, lower prices and a changed name: "Trilogy." Residents, who had taken over the guardhouse for mahjong, bingo and poker games, will get a 38,000-square-foot (3,530-square-meter) recreational center with indoor and outdoor pools, tennis courts and a card room.

"For the people here, the activity of construction equipment is music to their ears," said Eric Sorkin, 61, president of the homeowners association at the development, 35 miles northwest of Walt Disney World. "There's a future."

Builders are buying lots at less than half their original prices from lenders eager to move distressed construction loans off their books. Developments are being resuscitated from Florida, California, and Las Vegas to Utah and the suburbs of Washington, D.C., according to Brad Hunter, chief economist for Metrostudy, a Houston-based housing researcher.

"This is a natural progression of the cycle," Hunter said. "Projects fail, the price of the asset drops until it reaches a point where it's profitable for someone else to pick it up and remarket it. They reposition the project and then what was formerly infeasible, is feasible."

### Mothballed Projects

Builders, facing record low demand, are trying to boost margins and revenue by pulling unfinished projects out of mothballs. They're benefiting from cheap land and falling construction costs as they seek to adapt floor plans to today's market and lure buyers with prices that, in some neighborhoods, are little more than the cost of a foreclosed home. The 12 largest homebuilders by market value added 16,631 lots in their past two quarters, according to data compiled by Bloomberg.

The revived projects could contribute to a delay in the U.S. housing recovery by adding to the supply of available homes, according to Hunter. At the same time, builders are being cautious about flooding the market by limiting the numbers of houses they are constructing without

having buyers lined up, he said. Many homebuyers also aren't interested in foreclosures, which may be damaged or in inferior locations, Hunter said.

The next few months will show whether the revived projects will inflate supply, because many builders purchased lots around the same time, and will likely market them at about the same time, said Jill Lewis, homebuilder specialist for the Land Advisors Organization, a Scottsdale, Arizona-based land broker.

### Phoenix Communities

In the Phoenix metro area, 48 communities have reopened with about 40 more coming in the next year, according to Land Advisors. About 6 percent of finished lots for production are owned by banks, down from 20 percent a year ago, the company said. On average, new homes in Phoenix are going for half of what they sold for four years ago, Land Advisors said.

Picking up where another builder left off can be complicated by the passing of years. Without attention, weeds grow, swimming pools go green, government permits expire, and homeowners associations turn insolvent, said Taylor B. Grant, founding principal of California Real Estate Receiverships LLC in Newport Beach, California. Grant, who works as a court-appointed receiver for properties that have gone into default, is often asked by banks to prepare developments for sale.

It can take nine to 12 months to ready a site and construct model homes, said Tom Dallape, principal at the Hoffman Company, a land brokerage advisory firm in Irvine, California.

### Knocking Down Homes

Shea, which had some models in place, did it in a couple months. Soon after taking over the Cascades of Groveland, the closely held company began knocking down 16 partially built homes that "were sitting out there too long, and were not protected from the conditions," said Jeff McQueen, executive vice president for Shea Homes Active Lifestyle Communities.

Developers also are adapting projects to include smaller, more efficient designs that cost less to build, Dallape said.

"They're tailoring them to the market," he said. "The average new house used to be 3,000 square feet. Today, it's 2,100."

Publicly traded homebuilders such as D.R. Horton Inc., Lennar Corp., Meritage Homes Corp., KB Home, Standard Pacific Corp. and Toll Brothers Inc. started buying about a year ago as the market seemed to be strengthening, according to Tom Reimers, president of the California division of Land Advisors Organization. They deployed cash, which they amassed during the recession by selling land and taking advantage of a change in the tax code that provided them higher refunds, said Megan McGrath, homebuilding analyst with Barclays Plc in New York.

### Weaker Market

The housing market weakened with the expiration of a homebuyer tax incentive in April, and builder land purchases could slow as a result, McGrath said.

Sales so far in the restarted projects are relatively strong, Metrostudy's Hunter said.

Meritage, which builds in Texas, Nevada, Arizona, California, Colorado and Florida, has had a monthly pace of three sales per community in new projects compared with two for older developments, said Brent Anderson, vice president of investor relations. The Scottsdale, Arizona-based company bought 100 projects with 5,400 finished lots since the first quarter of last year and has reopened about half of them, he said.

"If these lots weren't available, it would be damn tough for builders to make a profit," Anderson said.

### Plunging Sales

New home sales slid 12 percent in July to a record-low annual pace, and existing-home sales tumbled 27 percent to the lowest level in a decade of recordkeeping, according to separate reports last month from the Commerce Department and the National Association of Realtors. Single-family housing starts fell 4.2 percent from June. Foreclosure filings increased almost 4 percent in July from the previous month, RealtyTrac Inc., an Irvine, California-based research company, said Aug. 12.

In Phoenix, where more than half the homes sold are foreclosures, demand is weak. The number of newly built houses and condos sold in July in the metro area fell to 641, down 50 percent from June and 38 percent from a year earlier, San Diego-based MDA DataQuick reported Aug. 26.

"All of us are going to sit back and evaluate the depth of the consumer market, and whether they are going to be chasing after the same buyer," said Lewis of Land Advisors.

Sales offices are only just starting to reopen. Newly acquired developments make up 20 percent or less of public builders' closings, and may reach about 50 percent for some companies by the middle of next year, McGrath said.

### Less Than Foreclosures

Candlelight Homes, a South Jordan, Utah, homebuilder that bought lots in 20 stalled projects, recently introduced a new slogan: "Quality new homes, less than foreclosures."

The company, which said most of its houses are cheaper than comparable foreclosed homes, has an average profit margin of 12 percent on the transactions, said Joe Salisbury, a partner at Candlelight. He purchases lots with power, sewer, and water lines and government approvals in place for 30 percent to 50 percent of what they sold for three years ago, he said.

“We’re buying lots for less than the cost of the improvements,” Salisbury said. “If someone offered me raw land for free next door, I wouldn’t even want it because it would cost me more to build out the lots.”

### Builder Flexibility

Development-ready lots give builders the flexibility to construct homes as customers sign contracts, and then ramp up quickly when the economy improves, said Robert Curran, a managing director for Fitch Ratings. Rather than paying for parcels upfront, builders often are acquiring the option to buy a minimum number of lots over a period of time, which gives them the freedom to walk away and simply lose their deposit.

“The fact that you can take a lot in and quickly build on it means you’re not tying up capital for an extended period of time and get better returns,” New York-based Curran said.

Private-equity firms are partnering with builders, big and small, to buy projects around the country and put them back on the market. Shea, for example, entered into a \$15 million joint venture with Mountain Real Estate Group LLC to revive the Cascades project, the Charlotte, North Carolina-based property investment firm said in a statement. Levitt & Sons LLC, which pioneered the planned suburban community of Levittown, New York, abandoned the Cascades project after it filed for bankruptcy protection in November 2007.

### Toll Brothers

Many public builders can finance projects on their own. Toll Brothers, the largest U.S. luxury-home builder, spent about \$340 million on new land in the first nine months of its fiscal 2010, adding 4,100 lots, its first rise since 2006. The Horsham, Pennsylvania-based company has \$1.64 billion in cash for more deals, Chief Executive Officer Douglas Yearley Jr. said.

“This is an opportunity to be investing that capital back in the market,” Yearley said in an Aug. 11 interview. “We have opportunities now that we haven’t had for some time.”

Toll Brothers paid \$23 million in February to SunTrust Banks Inc. for Hasentree, a foreclosed golf course community in Wake Forest, North Carolina, that was once appraised for \$78 million, said Tom Anhut, the builder’s group president in the state. Hasentree was built around an 18-hole course designed by Tom Fazio. It featured a completed community activity center, roads, about 400 acres of dedicated green space, 100 developed home sites, 218 raw sites, 18 new homes seeking buyers and 40 occupied houses at the time of the sale.

### Lower Prices

Buyers have put deposits on four new Toll Brothers homes, with listing prices starting at \$669,995 since Hasentree’s sales office reopened in July, Anhut said. The community’s original homes sold for an average \$1.5 million.

“This is really a special golf course and piece of property,” Anhut said. “But there’s a reason that we paid about one-third of the previous appraisal. Obviously, the market is different now.”

Builders are competing for land with investment companies, some of which are buying expansive projects and selling chunks to homebuilders.

Starwood Land Ventures of Bradenton, Florida, paid \$81 million in February for 5,499 home sites in the state, most of which were finished, from bankrupt builder Touse Inc. Miami-based Lennar has an option contract to buy about 1,500 of them across the state, said Mike Moser, east region president for Starwood Land Ventures, which is funded by Barry Sternlicht’s Starwood Capital Group LLC.

### Independence

Among the newly opened Touse projects is Independence, a master planned community in Orange County, Florida, with 500 finished lots, and room for 450 more, Moser said. Builders selling lots in the development include Lennar, Meritage, Ryland Group Inc. and closely held Ashton Woods Homes, he said.

“This product is in a very good location,” Moser said. “There is still demand for housing, and builders are eager to build homes.”

Residents of Trilogy, who have become close in the years since construction halted, are looking forward to having new neighbors, said Sorkin, the homeowners association president. The clubhouse, which Shea plans to complete in phases over the next two years, will be central Florida’s best, he said.

“It will attract many buyers,” he said. “And of course, it will be a wonderful retreat for people who live here.”