

Insider Q&A told land buying up, prices tumble

By Jon Lansner

Us: You say business has been good. How good?

Tom: In the third and fourth quarter of 2007 our brokers have seen a marked increase in the number of closings, escrows opened, and offers from serious buyers in Southern California. This is clearly a sign that the land market has hit a sweet spot for investors who think prices are low enough to be a good deal. We also think that this recent drop in land values is the precursor to a significant decline in home prices throughout the region.

In addition, many sellers' expectations on land sales – particularly in the markets that were over-heated a few years ago — have begun to match the lower pricing of homes. It's taken some time for land owners to adjust to the new market, but after months of their telephones not ringing, they are starting to come to grips with the reality that their land is not worth what it was in 2005.

The deals we have closed recently have been with land investors on well-located properties, primarily in the Inland Empire and the Antelope Valley. In September alone, we closed on seven land purchases ranging from key corner properties to swathes of land of up to 40 acres with a total value of more than \$30 million. They also include land that will be rezoned from residential to other uses. In one case, the Orange County division of Taylor Woodrow, a homebuilder, purchased 122 improved lots in Murietta. Since, then we have put an additional \$50 million in land deals under contract. So there continues to be signs of life

in the real estate market now, signs that simply were not there over the past year or two.

Us: How's pricing?

Tom: Land prices in Southern California have dropped dramatically, by as much as 30% to 50% in some markets. We're seeing that the prices for finished lots pulled back to 2002 levels in many cases, and may go down even further by next year. The bulk of that decrease is in the residual value of the land itself. The actual cost of development entitlement, grading, installing infrastructure has not changed that much. So the remaining portion of the equation, the land, is what has lost value and has the most elasticity.

While Los Angeles, Riverside and San Bernardino counties are experiencing significant price cuts on land, Orange County is more difficult to read. That's because there is very little land available for sale here, and all the large land holdings are controlled by either The Irvine Co. or Rancho Mission Viejo. Neither are under pressure to develop right away.

Us: Who's been buying? Vulture funds? Foreign investors taking advantage of a weak U.S. dollar to buy land here?

Tom: What has really caught the attention of our real estate brokers is who is buying. Most are individual investors using their own money, and some of the same people who were buying up land during the last down cycle of the housing market in the early 1990s.

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We've been dealing with disciplined land buyers who have long histories in Southern California. They sat on the sidelines during the peak of the market 2003-2005, when they felt that land values had gotten artificially high and unsupportable, and now are back making sound land investments. They know prices could still drift down a bit, but the risk of waiting on the sidelines is even greater. If they wait too late to get into the game, they'll be competing with the Wall Street money that could run values up if more than one group starts pursuing the same properties.

We receive calls every day from new opportunity or "vulture" funds, but have yet to see many of them purchase land in Southern California. We believe they currently have unrealistic expectations of the market and the types of deals available. We also have completed land sales for foreign investors, so I would say there has been a benefit to the weak dollar, at least in land sales.

Us: What's your outlook for land prices?

Tom: Our real estate team believes we are nearing the bottom today for land pricing, based on the types of deals and buyers we are involved with. The land deals out there today may not make sense for homebuilders, but they do for investors who are looking to buy and hold. That generally signals the bottom of the land market.

It may decline another 10% from the top of the market and these conditions may continue, but I think we will see the true bottom of the land market sometime in the next six to eight months. How long it will stay there — before prices start to come up again — depends on the activity and

competition that is generated and what happens in the housing market.

Although depressed land values aren't good for land owners, lower property prices may be good news for homebuyers. The biggest reason that home values were so inflated, and there was so little work force housing over the past few years, was the skyrocketing price of land in Southern California. The cost of a finished lot was so high in 2003-2005 that builders had to put up big houses — or raise their prices — to make it pencil out.

In the industry, the cost to complete a single-family home is roughly three times the value of a finished lot. For example, if you're paying \$200,000 a lot, you have to build a big home that will sell for at least \$600,000. However, if that same lot now costs \$150,000, you could afford to deliver a smaller house for \$450,000. So the value or cost of land often determines home values, and we should be seeing more affordable homes being built over the next several years.