

Signs of Confidence Emerge Among Homebuilders

Prime locations see stronger demand for finished lots and rising land values as large public builders reenter California markets.

By KARI HAMANAKA, Staff Writer

At the beginning of the summer in 2009, a noticeable shift in finished-lot acquisitions began taking place, pushing up land values and leading to speculation that residential homebuilding may finally be on the cusp of a turnaround.

“If the homebuilders are willing to make investments, it shows some stability and confidence in the marketplace,” said Norm Scheel, principal at **The Hoffman Co.** “I think it’s a good sign.”

However, the industry is closely monitoring foreclosures and resales, which stand to throw these signs of activity off balance.

“Everyone is watching what’s happening in the resale market because the resale market today on used homes has a large degree of foreclosure activity,” said Michael Vairin, president of the **Builders Development Group Inc.** and president of the **Building Industry Association of Southern California.**

“There appears to be a flattening or a stabilization, but the resale market is an area that needs to be watched because that market has a tendency to push down values significantly.”

In the short term, at least, the trend is seen as positive given three years during which values on land and houses fell.

“The homebuilders haven’t really acquired any land in three or four years, so they’ve built through most of the inventory that they’ve had or tried to sell properties,” Scheel said. “Now the homebuilders are coming to a point in time where their land positions are so small that they’re having to go out there today and start buying land for future development.”

According to the **California Association of Realtors’** January report, the state’s median home price increased 15 percent from the prior year while home sales decreased 10.6 percent.

“Despite the year-to-year decline, sales remained above the 500,000-unit threshold for the 17th consecutive month, holding steady at pre-peak levels from early in the last decade,” said Steve Goddard, CAR president.

CAR’s Unsold Inventory Index, which indicates the number of months needed to deplete the supply of homes on the market at the current sales rate, was 5.8 months down from 7.3 months for the same

period a year ago, and the median number of days it took to sell a single-family home was 33.8 days in January compared with 50 days a year ago.

Lot Values Jump

As publicly traded builders pushed into the market and began closing deals in the third quarter of last year, values jumped - dramatically in some cases.

An annual report by The Hoffman Co. surveying Southern California found lot values doubling or even tripling in some areas.

For example, by the end of 2009, finished lot values in the Dairylands area of Riverside County saw a year-over-year increase of 45.5 percent. The flood-gates really opened during the summer with **Standard Pacific Homes'** acquisition of 96 lots in the Eastvale market, which is part of the Dairylands area.

"That was a little bit of a wake-up call for some of their peers out there," Scheel said, "and then a number of other publicly traded homebuilders entered the scene at that point."

After that, the market saw interest from **Meritage Homes, Richmond American Homes** and **KB Home**.

In Northern California, bidding action at Fiddymment Farm is what many point to as the start of home-builder reemergence in that market. In the spring, Meritage acquired 41 lots in Fiddymment Farm from **Signature Properties** for a \$66,000 per lot. A few months later, in June, **K. Hovnanian** purchased 41 lots for \$68,000 each. When an August bid came in for \$103,500 per lot for 77 lots, Signature halted on the sales. Instead, the developer decided to start building.

"At that time, a few people had been looking, but no one had closed on anything," said Steve Smiley, a principal in the Danville office of **Meyers Builder Advisors**. "They [Meritage] were one of the first ones to do something and close as well. Now we're seeing all the public builders trying to buy lots and they're all pretty aggressive."

But aggression in Northern California has hardly resulted in the same increase in values that markets such as the Inland Empire experienced last year. This, Smiley said, is mainly because the lots that have sold have all been relatively similar with price tags hovering around \$70,000 per lot.

"They're going up a little bit, but not significantly," he said. "You don't have that many finished lots. If you had more, these guys would probably bid those up a bit."

Strategy Emerges

Although the rush to buy finished lots has been going on for several months now, it is only occurring in the A locations.

"They're closer to employment. They're closer to the freeway and these are areas that don't have as much [finished lot] inventory," Scheel said.

In Southern California, activity is taking place in Riverside County not only in the Dairylands but also along the Interstate 15 corridor from Rancho Cucamonga down to Corona. The Temecula and Murrieta markets also have seen activity along Interstate 215.

In Northern California, the State Route 65 corridor in Rocklin, Roseville and Lincoln is where the deals started. That activity has since spread into Elk Grove and Rancho Cordova.

In contrast, more outlying locations such as the Victor Valley or Coachella Valley are not likely to see the publicly traded homebuilders reenter the market for some time.

In 2009, finished-lot values fell 18.2 percent in Victorville, according to The Hoffman Co.'s land index. Values in the city of Coachella fell the most of any other Coachella Valley city by 23.1 percent.

“From a demand-driver perspective, we look to where the jobs are and in both cases [the Victor Valley and the Coachella Valley] the jobs tend to be back down the hill toward Ontario and Rancho Cucamonga,” said John R. Shumway, principal, in the Newport Beach office of **The Concord Group**.

Tertiary markets will continue to attract the interest of private investors and perhaps some of the smaller, private builders that do not have the same access to capital as a public builder would.

“If someone's buying a paper lot deal in a tertiary-level market area, they're probably buying it for a much lower price and a strategy of buy and hold and let the market catch up to that geographic market,” Vairin said.

Scheel added that existing inventory in the A locations would have to be absorbed before public builders start buying up lots in outlying markets.

All signs point to the business strategy of the publicly traded homebuilders to continue investing in finished lots and rebuilding business activities that had been on hold for the last few years.

Over the course of 2009, Arizona-based Meritage Homes, which builds in California, Arizona, Colorado, Florida, Nevada and Texas, reported it spent

\$150 million on more than 4,000 new lots in its fourth-quarter report. As of the end of 2009, the company estimated it had about 3.2 years worth of supply.

In its end-of-the-year report to investors, Hovnanian Enterprises reported that it spent the third and fourth quarters buying some 4,000 lots. And Standard Pacific reported in its fourth-quarter results that it spent \$35.3 million on land purchases during the quarter.

Dwindling Inventory

With renewed interest in lot acquisitions, finished-lot inventory has begun to dry up in some places.

An example is Riverside County's Dairylands, where much of the finished-lot demand has centered.

“The lot supply in the Dairylands has gone down very quickly because, when you look at the [I-]15 corridor, the Dairylands is the premiere area and people are looking for well located homes for the first-time buyers and first move-up families,” said Jeffrey Meyers, principal in the Corona del Mar office of Meyers Builder Advisors.

Scheel noted that when builders acquired lots in the Eastvale area they absorbed a large portion of the available supply.

“There were only three or four lender deals with lots that weren't in the hands of the ultimate homebuilder,” Scheel said. “Those lots were acquired by Standard Pacific Homes, KB Homes and Richmond American. That really took the bulk of improved lots off the market.”

As builders compete for the remainder of the fin-

ished-lot inventory, interest will inevitably turn to paper, or unfinished lots, but that is a trend that has not taken center stage among the public builders' business strategies.

"We're definitely making a big dent in the existing finished-lot inventory to the point that we would say that by mid-year we'll probably see a tapering off of this activity,"

Shumway said. "Then we think there will be a hiatus for a little and then those who wish to have a longer horizon will look at paper lots."

Shumway said he sees some paper lot acquisitions but only as part of larger acquisitions that include a mix of raw, finished and paper lots in the deal.

Meyers said for right now, it is mainly the private builders looking at unfinished lot purchases.

"It's early, but we're just starting to see that take place," he said. "Some of the builders are starting to discuss it. It's privates that are picking those up. The large institutional, capital funds have a minimum deal size, and because of that a lot of these paper lot deals are off their radar."

However, there is some movement by the public companies. Earlier this year, a Lennar-controlled partnership acquired 714 unimproved lots in the Rancho Bella Vista masterplanned community. The land is located near Temecula, in French Valley.

And in the coming months of 2010, Meyers said he expects at least four or five major land deals to take place in just the Inland Empire alone.

More specifically, many are awaiting announcement

of a buyer for the stalled Summerly at the Lake master-planned community formerly owned by John Laing Homes. The project, amounting to some 1,500 lots, is in the hands of the bank.

The sale could mean good news for the city of Lake Elsinore, but the overall sentiment of the housing industry is wait and see.

"The guys that you're seeing doing a lot of work right now are just the public builders," Smiley said. "Is it going to be the public builders only, or will we eventually see some private builders? I don't know. I think everybody is still kind of cautiously optimistic about the market. If you're a public builder, your job is to build houses, and that's what we're finally seeing happen."