THE MAGAZINE
OF THE NATIONAL ASSOCIATION
OF HOME BUILDERS

Builder

Gaining Ground

Small to mid-size firms find success by building on lots overlooked by big builders or infill, forming relationships with land owners, and finding capital partners

By Teresa Burney and John Caulfield

Over 40 years and through four incarnations of home building companies in Chicago, the Benach family learned a skill that allows them to compete against big, better-capitalized builders.

The clan can build and sell homes on close-in suburban and urban infill projects where other national and regional Chicago builders can't or won't.

Infill is the business model for the family's fourth company—Lexington Homes—that Ron Benach and his son, Jeff, along with CEO Wayne Moretti and CFO Max Pisak, started in October 2006. It's the same name of the original company the Benachs started in 1873 and sold to Westinghouse Electric in 1969.

"If the nationals want those big subdivisions in the suburbs, they can have them," says Jeff Benach, who points out that, while land might be cheaper in the suburbs, home prices remain stagnant.

Lexington Homes, which closed 30 houses in 2012, is finding land that the big production builders don't want: urban infill lots. And the new Lexington is willing to fit any type of project on those lots. "We'll do single-family, multifamily, midrise, even rental if the opportunities present themselves," Benach says.

Now that the home building market is emerging from catatonia, builders are scouring the country for land to meet the new housing demand, and they are having trouble finding good lots in the right place at the right price. This is particularly true for small to mid-size builders.

Because development of new lots all but stopped during the downturn, the pickings of finished lots where most people want to live—"A" and "B" lots—are scarce. And, chances are good if you construct houses in a major market, publicly held builders already have tied up the best lots.

While the total number of finished lots available is nowhere near as low as it was just before the recession ended, the numbers are deceptive because roughly 25 percent of them are in what Metrostudy, BUILDER's research company, describes as "D" and "F" locations—places so undesirable that nobody wants to live there.

So what can a smaller builder with less-than-plentiful capital do?

LIVE ON THE LEFTOVER LOTS

Jim Bagley, president of City Homes in Orlando, Fla., has access to lots through private equity. His advice to builders who don't: "If you have no capital, you have to go to the fringe markets, C markets, where your margins are lower, your velocity is lower, but you can live on it."

That's one strategy William H. Hoover, president of Texas-based Inland Homes, a franchisee of Inland Homebuilding Group in Tampa, Fla., was forced into when he started his franchise in San Antonio three years ago.

He knew he couldn't compete against established builders for spots in the best communities, so he had to find good communities that they had overlooked.

"We have been forced to find the lots that others don't want," Hoover says. He feels that being new to the area was an advantage because he saw opportunities with a fresh eye that local builders with preconceived ideas disregarded.

Case in point was an older community forgotten by local builders. It is near good schools and a mile and a half from Costco and Target. Because it was out of favor with local builders, Hoover got lots at good prices and terms. (He declined to provide the prices he paid or the terms.) Still, it took five or six months to convince a bank to finance the deal. But the payoff came quickly when Inland started selling in June 2011, and sold 24 houses in 18 months at good profits.

Hoover's other strategy was to find lots in good locations with problems other builders didn't want to deal with. He found a prime community on the north side of town with some gnarly leftover lots.

"The big boys will go through a community and they will pick the easy lots and then when the lots get more challenging they tend to leave them and go on the next community because they have a next community to go to," Hoover says.

In this community, the leftover lots needed a lot of rock excavation to make them suitable for construction. But they were cheap enough and, thanks to a good deal with a local excavation contractor, Inland made a profit despite the high costs of lot preparation. There was another side benefit as well.

"We are kind of a savior for developers with troublesome leftover lots," Hoover says. "You have got some ugly lots, let us come and finish out your community."

Hoover started doing business in San Antonio three years ago, so while he has successfully found leftover lots and expects to continue finding lots that way, he does

"If the nationals want those big subdivisions in the suburbs, they can have them."
—Jeff Benach, Lexington Homes

Land Banks Clear Path for Neighborhood Renewal

But builders and developers have been slow to embrace

What do Pennsylvania, New York, Missouri, Georgia, and Nebraska have in common? All passed legislation in the past two years that authorized the formation of land banks to reclaim real estate whose market value in its present blighted or tax-delinquent condition is all but worthless.

For adventurous builders and developers—especially those whose business models include infill aspirations—land banks hold out the promise of inexpensive, albeit risky, redevelopment options. And if this phenomenon expands, as some experts predict it will, land banks could become more important to metros trying to resuscitate neighborhoods and attract more residents and businesses.

One hundred to 150 authorized land banks are in operation across the United States. Typically, the banks are set up to serve counties or metros like Chicago, whose Cook County Land Bank Authority is scheduled to open this fall. And if all things fall into place as planned, Philadelphia could have its first land bank by mid 2014.

Philadelphia has more than 40,000 residential and commercial properties that haven't paid taxes in years or are vacant or abandoned. Various public agencies own about one-quarter of these properties. The game plan over time, says Rick Sauer, executive director of the Philadelphia Association of Community Development

"If you have no capital, you have to go to the C markets, where your margins are lower, your velocity is lower, but you can live on it."
—Jim Begley, City Homes

INFILL PROJECTS PROVIDE NICHE

BUILD STRONG RELATIONSHIPS WITH LANDOWNERS

FIND A CAPITAL PARTNER TO SHARE THE COSTS

"We used third-party land banks to bank land. We gave profits away to those land banks, but it helped us as we didn't have to raise capital to develop."
—Colin Wright, Henry Walker Homes

http://mydigimag.rrd.com/publication/?i=187277

December 2013