

Builder

LAND STRATEGIES



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

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ver 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.

"You can't build and sell homes on classic suburban and urban infill projects where other national and regional Chicago builders can't work."

Infill is the business model for the family's fourth company—Lacington Homes—that Tom Benach and his son, Jeff, along with CEO Wayne Marretti and CFO Max Pank, started in October 2006. It's the same name as the original company the Benachs started in 1973 and sold to Vantage Homes Electric in 1996.

"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.

Lacington Homes, which closed its books in 2010, is finding land that the big pro-

duction builders don't want: urban infill lots. And the new Lacington is willing to do any type of project on those lots. "We'll do single-family, multi-family, mid-rise, even rental if the opportunities present themselves," Benach says.

Now that the home building market is emerging from recession, builders are scanning the country for land to meet the new housing demand, and they are having trouble finding good lots in the right places 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 50 percent of them are in what Metrostudy, BILTUSA'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-ideal capital do?

LIVE ON THE LEFTOVER LOTS Jim Nagin, 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.

"I know he couldn't compete against established builders for spots in the best communities. 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.

One 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 not fevered with local builders, Hoover got lots at good prices and terms. (He declined to provide the price 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 26 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 poorly-labeled 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 modifications 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 writer for developers with trouble areas before they," Hoover says. "You have got some ugly lots, but we can do a lot of work on 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, Lacington Homes



Land Banks Clear Path for Neighborhood Renewal

But builders and developers have been slow to embrace

When do they start? 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 acquire and restore vacant lots in their present (dignified or less-dignified) condition to all but overcome

For adventurous builders and developers—especially those whose business models include infill opportunities—land banks hold out the promise of inexpensive, abundant, redevelopment options. And if the phenomenon succeeds, as some experts predict, land banks could become more important to municipalities by providing a means to acquire and restore vacant lots and address infrastructure and business

One hundred to 150 authorized land banks are in operation across the United States. Typically, the banks are set up to serve counties or municipalities like Chicago's Urban Cash County Land Bank Authority is authorized to cover the full. An ill-fated attempt to place as planned, Pittsburgh could have the first land bank by mid-2014. Philadelphia has more than 40,000 residential and commercial properties that haven't paid taxes in years and vacant or abandoned. Various public agencies can absorb a quarter of these properties. The game plan over time, says Dick Seac, executive director of the Institute for Community Development

Corporation, is to move a sizable portion of the land and build right into the bank and acquire as many properties as local real estate conditions will allow to get them back on the market.

Land banks are a new tool based on a "reality," says Frank Alexander, professor at Emory University School of Law in Atlanta, and co-founder and general counsel for the Center for Community Progress. Historically, these properties have been located in disinvested neighborhoods within a city's urban core. But, says Alexander, the last housing recession spread the plague to the suburbs, where tax sales and subdivisions succumb to foreclosure.

Land banks have become a solution for cash-strapped cities that need to rehabilitate rundown neighborhoods, but don't have the money or resources to buy down owners of abandoned properties or to do down-buildings. Land banks use the legal authority to take ownership of properties with decay or waste, settle former building titles and lien obstacles, demolish what can't be salvaged, and assemble and build new subdivisions through commercial lenders.

A few years ago lenders and underwriters—including banks like Wells Fargo and Bank of America—said Charlotte County Land Bank in Ohio (\$3,500 to \$7,500 per house to buy and tear down the worst foundations in Cleveland). This kind of public focus had some critics to land bank banking as an end in itself, ahead of building and unworkable competition for private developers. Proponents reject that argument and note that land banks aren't forcing anyone out of their homes, an sentiment doesn't change.

Depending on the city, a sizable portion of what land banks take over eventually will be demolished and ground over. Of the \$100-plus

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—Jim Bagley, City Homes



PHOTO BY MICHAEL D'AMICO

net lease have fruitful this strategy will be over time.

Henry Walker Thomas, which builds nearly every type of dwelling from condominiums to custom in Utah and Colorado, makes a point of picking up land that large public builders don't know about or aren't interested in to stay out of the "red fight" with builders over tracts.

CEO Colin Wright says the company finds lots in municipalities that have in-fill land to develop and use maybe mid-large houses. It also develops brownfield projects and jumps on property that banks are holding onto.

"We pride ourselves on being really opportunistic," Wright says.

INFILL PROJECTS PROVIDE NICHE Most year, California Home Builders (CHB) will celebrate its 20th anniversary. Over those two decades, the Corona Park, Calif.-based builder-developer has survived in the land of giant builders by its willingness to fill gaps ahead of changing markets.

The company, says the owner and CEO Steve Dornheim, started out building custom homes. But within two years, CHB was in production home building with a focus on in-fill projects, which have been the foundation of its business model ever since.

Last year, CHB closed 130 multifamily units and 60 single-family homes. It currently has two multifamily projects of 41 and 41 units, respectively, that it adds to investors who are starting them.

Evenham says his game plan calls for selling larger multifamily projects to investors, and selling single-family homes and smaller multifamily projects to banks before

the projects about 60 single-family closing this year, rising to 300 single-family and 200 multifamily closings in 2014.

Nationally, in-fill represented approximately 21 percent of new-home construction in metropolitan regions from 2010 to 2010, according to the U.S. Census. What makes an area more attractive for in-fill development? The U.S. Census found that many builders already know that in-fill typically happens in areas where home prices are high.

Most metropolitan areas make a difference. Metropolitan areas with more transit ridership and miles of rail transit also tend to have higher transit in-fill, compared with those cities and suburbs without a big investment in mass transit.

BUILD STRONG RELATIONSHIPS WITH LANDOWNERS A few months ago Rob Bowman, president of Charter Homes and Neighborhoods in Lancaster, Pa., was in a heated contest to buy an attractive piece of land. In the end, he went for a size of Charter's self-developed, award-winning neighborhoods. They also visited Charter's Valdez Crossing Community, a successful mid-rise townhouse attached to a major Walmart store.

The owner, impressed by Charter's effort to communicate, ended up giving Charter the land contract.

"He said, 'My father passed away and I believe he would think I'm making the right decision. Could we name one acre after my dad?'" Bowman recalls. "He had kind of emotional attachment, that connection, the ability to give landowners that kind of value in the property" that convinced them to sell their property to Charter over other bidders.

The deal, president of Real Communities, has been a home builder in the South-west Florida area since 1968. Arguably, he knows every large farmer or rancher from Tampa to the Everglades. It's likely that he's not down at their kitchen tables passing on this message: "When you get ready to sell, give me a call."

He knows when to track down every one

of them when necessary.

Thomas says, if I went to talk to him, I go to St. Peter and Paul's Aqueduct church on Saturday afternoon," he says.

There are land banks in Florida that Real has been tracking for 25 years. It's unusual one land owner for two years before finally getting the deal.

"Real, who likes that he asymmetrically maintains his position because Tom (Bly) turns into the bank's" experience, has earned a lot of respect from local landowners in a large swath of the Sunshine State. At the same time, many large public land banks working in the area are not the most successful when they stand on their heels when the market is hot.

"They have earned a reputation for being harder to deal with because they are short-term in their relationship with the private builder to live in the community," Real says.

Because of what Real calls his "symmetrical" knowledge of land assets, the acquisition of land owners, and the planning and zoning reviews and shakers in local governments, he has purchased plenty of land to find his company's geographic climb in home sales. Real Communities bought 10 parcels in 2012, 100 homes lots. Real's strategy is to effectively pay as much as the market value for the land, but with enough lead to give him home building needs will follow land that plans to sell to public builders.

"I would have brought another acre, eight, or nine [parcels of undeveloped land] if I had been willing to pay as much as the market value," Bowman says.

Bill Handley, president of CEO Thomas in St. Louis, Mo., has been successful using similar strategies.

"My game plan has really been to be very decisive and move quickly," he says. Like Neal, Handley is visible in the community and easily reachable. "I think the advertising and local PR we do get me calls as well," he says.

To gather the land, Handley taps into a network of local contacts, including landowners. He works in touch with engineers, real estate agents, subcontractors, former owners of land, friends of friends, and former customers.

"All of these have made calls and introduced me in direct contact with landowners wanting to sell," he says. "I have also tried to be the first call from local banks with land to sell."

As a result, Handley currently has a strong land supply—not a bad achievement considering he's in Florida and he also has been climbing.

FIND A CAPITAL PARTNER TO SHARE THE COSTS

Of course, even the best land deal requires cash to buy, more money to develop it into lots, and even more funds to market and sell houses on it. While it's rare for privately financed home builders—particularly small ones—to acquire cash in the quantities that public companies have, there are some partnering options.

"You better have a land capital partner because that's how the public will understand," notes Wright of Henry Walker Thomas. "They have more access to capital."

David said then alone, true, but not impossible.

"The capital is one-changing, ongoing battle," says Wright, whose company initially was funded by costly private equity capital. "We would third-party land banks to bank land. We give profits away to those land banks, but it helped us as we didn't have to raise capital to develop."

That partnership helped Henry Walker Thomas build houses and make profits that made its balance sheet more desirable to banks as time went on.

"We look better as a company now," Wright says. Plus, he adds, banks are more willing to loan money today to build homes, if you buy the land to get them on.

There also are less traditional ways for a cash-strapped builder to acquire land. In Yuba County, Fla.-based Black Orchard Equity, for instance, recently bought 1,500 vacant home lots and 1,200 acres of other land across the acreage from Black Capital. Tom's subsidiary formed during the recession to work on distressed land assets.

Black Orchard's managing director, Mike Whitman, is striking partnerships with home builders at favorable terms to build homes on the land. In some cases, Thompson is turning the lot titles over to the builder with the agreement that they would pay Black Orchard for the land after the home is built and sold. That direct builder ownership makes banks more comfortable with lending cash to build the homes.

Turning the payment for the lot means the builder doesn't need to take money out of pocket to buy the land. "We are looking for builders [to partner with] that are aggressive, crafty, and looking for long-term relationships," Thompson says.

Essentially, to successfully find and buy land in the currently overheated market, builders without the deep pockets to compete head-on with public home builders must find land they don't want or don't know about, cultivate relationships with land sellers, and find financial partners to help pay for it.

Consider Lexington Homes' example by buying land where large public builders are not. In September, Lexington Homes

opened three subdivisions, two of which are in Palestine, Ill.: Lexington Mills, with 41 units; and Lexington Oaks, with 11 units.

That same month, the company also opened the second phase of single-family homes and third phase of townhouses at its Lexington Square community. Located in the north end of Chicago's diverse Bridgeport neighborhood, Lexington Square is a new eight-block from U.S. Cellular Field—home to the Chicago White Sox—and will offer 30 single-family homes ranging from 1,000 to 1,500 square feet and starting at \$207,000, and 11 two-story townhouses ranging from 2,250 to 2,527 square feet and starting at \$315,000.

This year, Lexington expects to double its closings to 60 homes, and co-principal Jeff Bensch says that velocity would be much higher if his company had more land.

"We need to start buying land more aggressively," he points out. At the moment, however, Lexington is narrowing its focus on purchasing smaller parcels—no more than 100 lots.

Bensch says that he and his 60-year-old father have no desire to build Lexington Homes into a behemoth. "We want a nice, manageable company that's building 200 to 300 homes a year to four to seven subdivisions," he says.

Lexington is in good shape financially, he says, with bank relationships that allow it to finance projects. "Before a shovel goes into the ground, that's unusual for most builders these days."

"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 Thomas



PHOTO BY MICHAEL D'AMICO

properties that First, Utah-based Geneva County Land Bank has in its inventory, it will have close to 1,000 to 1,200 homes, which is only about a fourth of the acreage that could be developed, says executive director Doug Wladan.

Over the years, Geneva has had to develop from an underfunded, undercapitalized, and underperforming organization.

Other land banks are funded to varying degrees. The office of New York Attorney General recently allocated \$30 million in grants for assembled banks in the state. Chicago is funding two land banks in Cook County with \$5 million from a large warehouse that Illinois won against big banks for foreclosure and mortgage fraud.

Meanwhile, Lucas County Land Bank—with an annual budget of around \$1.8 million—has many programs in Ohio and other states that land banks there have through sometimes imposed on property-tax revenues.

The bad news model of many land banks is to eventually operate on proceeds from sales and to reacquire once properties are repaired or cleaned and then resold.

One of the more active land bank customers has been Habitat for Humanity. Emory University's Alexander points out that over the past 15 years, the Atlanta Land Bank Authority has been providing oversight of properties in South Atlanta to the local Habitat chapter for as little as \$2 per lot.

Since 2008, Habitat Dallas chapter has acquired 120 lots from the Dallas Urban Land Bank, at an approximate cost of \$150,000.

"It's difficult to get the land bank to clean up the mess before transferring the land to us," says Thomas Schick, Dallas Habitat's director of public policy and government funding. —J.C.

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