

## **Surviving and Profiting from the Collapse of The Homebuilding Industry**

Housing developers have fallen on difficult times and those times are expected to worsen. The bust in the real estate market, and especially in the homebuilding industry, can be traced back to mortgage lenders who took leave of their senses. Lenders began offering mortgages to people with little or no verification of borrowers' incomes or ability to repay loans. These mortgages, sometimes referred to as sub-prime mortgages, have low initial interest rates that rise over time.

When real estate prices began to flatten out and interest rates crept up, sub-prime borrowers became most vulnerable. Soon, they found themselves in homes that they could not sell or re-finance because they owed more than their houses were worth.

The future is looking bleaker than the present. In 2008, \$680 billion worth of adjustable-rate mortgages are due to reset, according to Bank of America. Nearly three quarters of these adjustable rate mortgages are sub-prime. Adjustable rate mortgages change rates after two or three years, and the loans due for reset were written in 2005 and 2006, when underwriting standards were bent the most.

The proliferation of these easy access mortgages seemed to be weighted in former housing hotbeds such as California, Nevada, Arizona and Florida. One Credit Suisse analyst has estimated that 40% of those markets are at risk for "significant fallout" from tightened credit and increased regulatory scrutiny.

The domino effect of the sub-prime fallout can be felt in many industries. As borrowers defaulted on their loans, and potential homebuyers who hadn't jumped in yet stood on the side, developers began to lose money. Many developers overextended themselves by buying land they can't develop and unfinished homes they can't sell. This causes the builders' income to dry up, which leads to an inability to fund marketing campaigns, which further hinders sales. This in turn leads to having no need for sub-contractors, who then lay off their employees. Basically everything grinds to a halt. Another way of saying it is, some developers became "development junkies" and set themselves up for an eventual fall.

In addition, builders continue to burn through cash to cover expenses that build even as construction stops. A partially developed subdivision with houses in various stages of construction is a playground for any inquisitive child or teenager. The risk of injury or worse assures that insurance premiums will run high. Real estate taxes and interest are but two more expenses that do not end with the halting of construction. Current lenders are willing to work with developers, albeit at a steep price, with hopes of maintaining the relationship until the market swings back around.

These woes are not affecting just small time builders but luxury builders as well. Although luxury builders are somewhat insulated from sub-prime mortgages, tightening

lending standards may cause some buyers who had stretched to buy a luxury home to be denied a mortgage. In addition, many buyers have cancelled contracts for purchasing luxury homes, as they are unable to sell their current homes.

Homeowners in partially completed communities are also apprehensive about the current market situation. Not knowing when or if the current builder, or another builder, will be able to restart construction is the homeowners' main cause for concern. Related to their angst if no one steps up to finish the community, is the concern about the re-sale value of their home. According to a study by the Georgia Institute of Technology, a home loses 1% of its value for each foreclosure within an eighth of a mile. Other concerns include impeded or scrapped plans for shopping and entertainment development until the builder's woes are resolved.

All of this leads to housing developers falling into financial distress and in need of assistance to weather these troubling times. This turmoil presents an abundance of opportunities for turnaround professionals. The housing development industry, the construction industry (including the remodeling industry), and sub prime lending industry are all experiencing trouble, and many companies within these industries have either closed their doors or are on the verge of doing so.

Acquiring new financing, preserving cash by dramatically reducing costs, selling off inventory, and selling undeveloped land, are a few of the recommendations a turnaround professional may bring to the table. Merely relying on sales incentives is not the answer as prospective homeowners are waiting for the market to hit even lower price levels before they enter the market.

New financing may be difficult these days with lenders being so risk averse with regards to the real estate market. However, as noted earlier in this article, some lending institutions are willing to re-finance a loan in order to maintain their relationship with builders. The turnaround professional that has a solid relationship with a lender may be able to mitigate the additional restrictions that would come with a new loan. Deferring interest and spreading out land acquisition payments are a few things a turnaround professional may attain.

In order to generate cash, developers must sell their inventory. The inventory of unsold homes is the largest since the National Association of Realtors started keeping track of this figure in 1999. Builders have begun to offer deep discounts as well as incentives and must continue to do so. When consumers are offered what they perceive to be "an offer they can't refuse" then homes will start to sell. In addition, developers bought acres and acres of land when the housing boom was at its highest, and now find themselves with an abundance of undeveloped land. This ties up quite a bit of their liquidity and the wise thing to do is to sell idle land and concentrate on finishing the communities where they have started to build but have been forced to stop.

Re-zoning is another area to look at. Commercial and mixed-use development may be an option for undeveloped land. Obviously, there would be fees involved along with getting

the required approval from the local city zoning board, but if the new idea fits into the overall development of the area, it may get approved. City and town leaders may be more apt to re-zone an area rather than have a potential eyesore of vacant or partially completed lots.

The housing bust has also affected the construction industry, and turnaround professionals will see opportunities in this industry. With the tightened credit controls, even financially sound individuals are finding it difficult to be approved for a mortgage. Many of these people may decide to stay put in their current homes and make improvements and renovations. However, even the house remodeling industry is not sanguine about their prospects as it sees the extreme caution by homeowners chilling their desire to pay for large-scale renovation projects.

Many experts predict the housing ills could last another three to four years, essentially into the next decade, and it certainly appears that the bottom has not been reached. However, with the assistance of a turnaround professional who can formulate a restructuring plan that will generate cash and relieve inventory and land, home builders can weather these difficult times and return to a profitable environment.

While Wall Street and most everyone else is looking at the downside of the real estate market, people will still need homes. The time is ripe for turnaround professionals to utilize their skills and control the fall and manage the recovery of the homebuilding industry.

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