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The next residential boom should be here already

It is not surprising that the "Savings and Loan Crisis" has focused on a number of home builders turned developers who purchased a savings and loan association. These people learned that by offering high interest rates they could mushroom the S&L's deposits by attracting brokered funds. They were then able to finance their own land developments and the homes built by their associates, other builders. This led to the largest boom and bust in the history of the residential lot markets of Dallas-Fort Worth, and their suburbs.

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GUEST COMMENTARY

Today, there is enough demand to make the local market boom again — but a lack of liquidity in the homebuilding industry is holding construction down artificially.

From 1983 through 1987 there were 162,000 single-family residential lots developed in Dallas/Fort Worth (D/FW). During those five years approximately 120,000 of these were sold to builders who built homes that were sold mostly to first-time home buyers (according to American Metro Study Inc.). These buyers were primarily young people who moved here from the Northeast or Midwest and Texas baby boomers who were forming families and moving out of apartments. During this time the D/FW population grew by approximately 500,000 people and jobs were being created at an average of 50,000 per year.

Banks were following the lead of the savings and loans who were lending brokered deposits from Wall Street to developers to satisfy the apparent demand for new housing. Typically, a loan included 70 percent of the estimated retail value of all of the lots in that particular subdivision. There was a false sense of security developing, however, as the projections for selling off the lots at increasingly higher prices to builders was based on the continuation in the huge increase in demand which began in 1983. Thus, market studies completed in 1985 would show spectacular success for new projects if they were based on the last two year's trends. Even tempering the projected sell off of lots by 30 to 40 percent did not come close to what actually happened. By 1987, lot demand had slowed by one third to 20,000 per year from its peak in 1984. This demand bottomed out in 1989 at approximately 12,000 per year when D/FW had an inventory of 71,000 vacant developed lots.

By 1990, nearly every money center bank and S&L, was taken over by an agency of the federal government and virtually no construction lending for speculative housing was occurring. Only the corporate finance departments of major builders were able to finance construction of new speculative homes in this market based on the strength of their entire balance sheet. By some city's standards, Dallas still had a healthy demand (12,000 new homes per year). However, most of the homes that were selling during 1988-1990 were already built and were sold out of inventory. By the spring of 1990, many of the markets had less than a three month's supply of new homes while 71,000 lots languished on the ground because most builders could not get financing to build speculative homes.

The drop in job growth, in-migration and the severe lack of liquidity dealt a death blow to all but those builders such as Centex (Fox & Jacobs), Weyerhauser (Centennial), Pulte and developers such as Mobil Land Development, Arvida and Folsom that were large and diversified enough to withstand the drop in price and sales. This group, however, held only 5 to 10 percent of the lot supply. The other 90 percent, inlcluding developments like Stonebridge Ranch, Deerfield and the Valley Ranch, was taken back through foreclosure by the region's banks and S&Ls eventually to become part of the RTC and FDIC holdings. This asset class was more affected by the real estate depression than any other type of property.

Nearly the entire inventory of single family lots fell in the hands of the government and very little new development occurred between 1987 and 1990. How did this phenomena affect the value of the lots?

Today in many of the D/FW markets, investors have purchased developed subdivisions from regional lenders and the RTC at bargain prices. A healthy demand exists in some suburban markets for lots where builders are willing to pay the investor's interest costs and taxes during a lot sell out period in order to control a share of that market. Thus, lot values are rising at nearly twice the inflation level, albeit at a price well below replacement cost. Most of the subdivisions in which the lots are located were partially sold out during the market's heyday. Thus, a subdivision of 160 lots may have 100 vacant lots and 60 with occupied homes. The lender (FDIC, RTC) is marketing the 100 remaining lots at one price for a bulk sale.

In a recent survey, Newmarket Group Southwest found that the typical selling price has been 45 to 65 percent below the lot's retail price at the time of sale. When one factors in a 10 to 12 percent per year increase in the price of the lots to the builder, this discount could reach 60 to 80 percent, making for spectacular profits.

Once it became evident that the Dallas-Fort Worth economy was rebounding in 1988 and 1989, many investors sought Class A multi-family properties. This slowed down only after yields had been driven down to 6 and 7 percent based on the property's current income. Today, developed single family land has eclipsed apartments as the most lucrative and sought after investment in our recovering economy. What is unfortunate is that the owners, lenders and government agencies are not enhancing the value of these properties by setting up sales contracts for builders with take-down lot schedules and providing construction financing for new speculative homes.

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Local demand in 1990 probably reached 13,500 lots. The biggest constraint to our market is the inability of builders to finance and construct enough homes to satisfy the demand.

Most markets will not see new lots developed until 1991 or later. With growth approaching 30,000 to 35,000 jobs per year and the population increasing again, the investment in such a property at a 50 to 60 percent discount from retail lot prices is as safe as any investment in land.

Why else would Centex Corporation (Fox and Jacobs) have purchased 300 to 500 lots in 1988 and 1989 at prices 25 to 30 percent below what other builders were paying in 1990? They understood that cash was king and in such a market were able to acquire some of the best of the existing lot inventory. Others are recognizing the continuing demand for new homes and have targeted the developed lot inventory as an oversold, poorly managed asset with tremendous profit potential during the next few years.

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