

Sacramento Business Journal - February 25, 2008

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Friday, February 22, 2008

Homebuilders large and small face greater financial risks

Firms that held back during boom could emerge from downturn stronger

Sacramento Business Journal - by [Michael Shaw](#) Staff writer

Kimball Hill Homes made an unusually candid statement for a homebuilder, saying last month in a filing with the **Securities and Exchange Commission** that it has "substantial doubts about whether we will be able to continue" homebuilding operations.

Kimball Hill, the Sacramento region's 24th-largest builder last year, might be one of the most honest about its financial position, but it is likely not the only one with serious doubts about viability. Looking at the Greater Sacramento market, there simply isn't enough business to go around.

New-home sales fell to 7,500 last year, less than half of what they were in the boom in 2004, despite plummeting prices.

With thousands of foreclosures, the median price for resale homes dropped 23 percent in a matter of 10 months to \$285,000 as of December, according to the **California Association of Realtors**. And brokers are predicting that land will be sold at pennies on the dollar as some firms struggle to stay afloat.

While that's grim news for those at the bottom of the housing crunch, it's not all gloom for those at the top who can capitalize on misfortune.

"I think Elliott will emerge as the top builder," said Ed Benoit, a land broker with **TRI Commercial/CORFAC International** in Roseville who has been working with Elliott Homes and others looking to buy land cheap. Benoit said owner Harry Elliott III exercised restraint that was largely absent from many of his competitors during the housing boom.

"He'll make some exceptional deals this year," Benoit said. "Because of his standard business practices of not over-leveraging himself, he's in the right position."

If a homegrown builder such as Elliott Homes is to emerge from the housing downturn at the top, it will probably be at the expense of publicly traded national builders that were some of the biggest winners locally during the boom. Last year, 11 of the top 12 builders were big public companies, with only Sacramento's **JMC Homes** cracking the top 10 based on sales volume, according to analyst

Hanley Wood Market Intelligence.

Despite growing market shares in Sacramento, some of those companies are believed to be on shaky ground.

Citing investment analysts, The Financial Times of London recently reported that bankruptcy risk among the big U.S. homebuilders is up sharply, naming **Standard Pacific Homes**, **K. Hovnanian Homes**, **Beazer Homes** and **Meritage Homes** as the most exposed. Those companies control 15 percent of the six-county Greater Sacramento market. If they are forced to sell off or reorganize, it could be a bounty for well-capitalized developers or builders.

Not all analysts who track homebuilders' financial circumstances and stock prices are concerned about bankruptcies.

Goldman Sachs analyst Chris Hussey reported late last year that builders such as **Lennar Corp.** and **K. Hovnanian** show some "vulnerability" in their book values. But Goldman Sachs is still neutral on the industry as a whole and has even advised investors to buy companies such as **D.R. Horton**. That's because the public builders that can survive the downturn are also poised to increase their share once the market corrects.

But bankruptcies might be inevitable before that point is reached.

"I don't see how they all make it through this," said Dean Wehrli, a vice president with new-home analyst The Sullivan Group in Elk Grove. The financial picture for Sacramento's private builders is more difficult to discern, unless they're like Kimball Hill and are required to report to government regulators. The Chicago-based company posted a net loss of \$220 million for 2007 and announced a partnership this week with Wells Fargo Home Mortgage to try to move more buyers into its product.

The Business Journal has documented struggles for local developers **Reynen & Bardis Communities Inc.**, **Dunmore Homes** and others, but there's no clear indication of who will survive.

Wehrli said some smaller firms could escape financial ruin by shifting into the role of master developers, which would reduce employees and expenses. That would come at the expense of the homebuilding brand, which would suffer from any retreat.

"The major public builders think in terms of market share and brand," he said.

Selling off assets to generate operating cash is a key tactic of staying afloat, and the big winners could be those based outside the region that swoop in with institutional or Wall Street money.

Benoit said some Canadian investors are seeking to cash out of their holdings north of the border, which they believe have peaked, and are looking to find steep discounts in the Central Valley.

In the worst housing slump in years, there is a chance for success.

"We've got about 7,500 new-home sales last year and probably the same this year," Wehrli said.
"Somebody is going to have to sell those homes.

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