

Lots of Opportunity

Buying a building lot isn't supposed to be complicated. You find it, you like it, you buy it, right?

If life and business were only that simple.

Let's just say that the location and price look good, but the costs of finishing the lot are too high to make it pay. Or maybe it won't meet percolation standards. Perhaps excessive slope would drive up your costs. Or maybe zoning restrictions would require lots that are too big – and costly – for the homes you intend to build.

Then there's the chance that after you build a traditional home and plan two more, you find out that six nearby builders are putting up contemporaries. Or you go up-market and find out the guys on either side are building tract-type housing. Or the big developer across town pushed through the zoning for townhouses on the tract that abuts the rear of your lot.

Maybe you're hit with a no-growth referendum and now on land you can't develop. Or you buy enough lots to last two years, and then land and home prices sag before you develop half of them. Or you can't find the cash flow

to buy lots at soaring prices and still turn around enough units to support your business. Or you find the lots, but you lack the cash, and your banker won't lend you more until you close on the homes you're building now.

If it sounds dire, and all too familiar, don't think you have to look for another line of work. Buying lots is manageable if you plan well and invest prudently.

Michael Carliner, staff vice president for economics and housing policy with the National Association of Home Builders, says a builder, to remain competitive, ought to keep his finished land costs to about 25% to 27% of the selling price of his home. "You should be uncomfortable – and this does occur – if the finished lot costs more than 30% of the selling price of your house," Carliner says.

Looking at total lot cost, Carliner says, a sensible breakdown falls along these lines:

- Raw land – 40%
- Lot finishing costs – 40% to 45%
- Fees – 15% to 20%.

Carliner says it's important to understand the dynamics of the local econo-

my. Rapid and continued inflation of land prices should not trigger a reflex action that tells you go out and buy as much land as possible before the price goes up even more. "If the price can go up 100%," he warns, "it can go down 50%. You have to take some risks."

The one risk you don't want to take is that you're holding too much land at inflated prices. Land speculation is riskier than buying land and building houses. "The value of a house won't go down," Carliner explains, "but the value of land will." So, by that reasoning, the more money you tie up in speculative land, the more susceptible you are to market swings.

The important factor, he says, is whether the land can be bought and finished at a price that will make the home competitive. Any costs that are assumed must be manageable within the business plan. That also means keeping abreast of political developments that may determine the future of your lots: zoning changes, sewer moratoriums, and growth referendums.

Here's how three builders are facing up to the peculiarities of their markets with different approaches to buying land.

Affordable building lots are a fast disappearing commodity. Here's how three builders select and buy the right ones.

by
**Gary
Mayk**



Buying lots in an existing subdivision is the right solution in some markets.

Hitching a Ride With a Developer

Doug Hatcher
DougAnn Homes
Marietta, Georgia
Homes per year: 8-10

Doug and Ann Hatcher and David McElreath of DougAnn Homes buy more than land when they buy building lots from the developer Means Brothers, Inc. They also buy marketing services, design help, safeguards against shoddy development nearby, and an intangible – cooperation. They feel their practice of taking down about eight lots a year in one or two Means developments gives them an edge in a competitive market.

Doug Hatcher says, "We've been selling in both Means subdivisions pretty steadily. There's no reason we can't go somewhere else." But there's a good reason they shouldn't: "Cash flow."

Buying scattered-site lots and marketing the houses, Hatcher says, "takes a critical amount of money." It's money the Hatchers and McElreath don't have. So, they look for alternatives. One is to buy leftover lots, or "out-parcels," in developments that have been almost totally sold out. "I'm not sure I would ever buy an out-parcel," Hatcher says. "If you don't have the marketing and traffic, it's hard to sell. I do know some who do it. If you sell, you make out."

In the first development where the partners bought lots, one home took six months to sell. That hurt. They also disliked some of the homes going up around theirs. "That subdivision had no controls," Hatcher recalls. "I didn't want to start a traditional home and see contemporaries going in."

DougAnn decided that building in a subdivision would be the right move only with the right developer. When a Means Brothers agent was impressed by DougAnn quality, she invited the builders to apply as a Means builder.

Homes on Means sites sell for \$134,000 to \$165,000. "Lots are about 1/3 acre, some bigger," Hatcher says. "In the Arbor, the price is about \$29,000 to \$30,000. In the Fairways, they're about \$38,000. If they back up to the golf course, they're \$42,000-\$45,000. They're not cheap." Still, Hatcher feels the lots are a good value.

Part of his reasoning is Means' choice of builders. The developer screens builders by examining homes they've built and by talking to past customers. If a builder ignores his punch list or callbacks, Means rejects him. Hatcher says, "We're real pleased. We like the way they go about what they do."

Means finances the purchase of the building lots by builders. It tries to speed up the turnaround through sales leads. Going that route was an idea that at first seemed not to be working as planned. "We had to pay interest when the first two homes sat," Hatcher says. "Then we had a couple of pre-sales. Basically, the pre-sales came not directly through us, but through real estate advertising they do on a Sunday morning TV promotion." One buyer rejected a completed house as too big but liked the quality enough to contract with DougAnn. The other buyer

signed after seeing a DougAnn home they'd built elsewhere.

Now, Hatcher says, he values the sales efforts but also likes other aspects. "They work with you real well. We go to them for suggestions on house plans and floor plans." For a design problem, the developer's architect will modify the plan – at no fee. A committee reviews all plans to make sure designs are complementary but not repetitive. Landscaping gets done at a lower rate because it's through one subcontractor. And because the projects are planned unit developments, they include upscale amenities that help sell homes in the Atlanta market: community recreation facilities such as clubhouses, pools, playgrounds, and golf courses.

DougAnn makes an effort to set itself apart from other builders in the same development. "My wife coordinates colors, and she uses more trim. We also use floor trusses as a selling feature," Hatcher says.

Building as one of several builders in someone else's development gives DougAnn a base of operations for up to two years. But, Hatcher says, it still allows his small firm to build a couple of higher-priced custom homes a year outside the development when the demand arises.

Letting the Seller Finance Sal Gambino

Tri-Cat Development
Bushkill Township,
Pennsylvania
Homes Per Year: 8-10

Sal Gambino used to be a New Jersey builder. Now he's a Pennsylvania builder, buying lots and building homes about 45 miles west of his Somerville, N.J., residence. He still laments the New Jersey market conditions that ended his building career there. "If I could drop up to \$125,000 on a lot and still make money, I would do it," he says.

But quite simply, he can't.

Instead, he buys bigger Pennsylvania lots – an acre, compared to a quarter-acre in New Jersey – for a fraction of the cost. His greener pastures are the farmlands of Pennsylvania's Lehigh Valley. Home and land prices in the Valley have doubled in the past four years, largely because of an influx of New Jersey and New York residents hungry for affordable homes. Still, the homes are a relative bargain.

"When we started," he says of the Bushkill Township, Pa., area, "we were buying unimproved lots that were \$30,000. Now those lots will run \$45,000 to \$50,000." Costs can vary, however. "We can still find unimproved land that costs \$10,000 to \$15,000 an acre, and it costs us \$5,000 to \$7,000 to improve it," he says. Municipalities catch on, too. "My first permit cost me \$75," Gambino says. "My second cost me \$240."

Gambino and his partner, George Robert Farley, who has moved to Pennsylvania, try to keep their lot development costs to a third of the raw land cost. "One-half is the maximum," Gambino says of finishing costs. "At one-half, I say to myself, is it worth it?

Or to heck with it?" When he can, he looks for land with road frontage. Not having to build a road can cut thousands from the cost of each home.

Gambino looks not only for ways to make lots pay, but also for ways to pay for lots. Gambino and Farley don't always use cash or bank financing to buy. Sometimes the owner will finance the deal at mutually favorable terms, largely for the comfort of knowing that the development will be desirable.

"For this development, the woman who sold us the property is holding the mortgage – she'd get hit with taxes anyway if we bought it outright. This is costing me more for the land. I'm paying \$25,000 per lot; each costs me \$33,000 with improvements. But it helps my cash flow. She said, 'When you sell a house, you pay me.' She's happy; we're all happy."

For now, Gambino is also happy keeping his margin down and selling quickly in a market that's flattened out in 1989. He uses Rhule Realty, a small agency owned by a veteran agent, to market the homes. When he can, he'll build on contract rather than spec. He's also cutting some frills on his four-bedroom, \$140,000 colonials of 1,800 square feet. Just a notch up the market, homes listed at \$180,000 are languishing.

"You've got to flow with the times," Gambino says. "It's getting a little tough right now. You have to be careful about what you do. I pay \$1,000 for a lot assessment fee. Imagine a 40-to-50-lot subdivision. That's \$40,000 to \$50,000 right off the bat, before you can even move an ounce of dirt. I'm better off doing a little development and a few custom homes. If there's a boom, I'll go buy a big tract. But I don't see that happening – not for five, six, seven years."

Coping With Inflation, No-Growth

Page Nelson
Shelter-Belt Homes
Berkeley, California
Homes Per Year: 10

In the rolling hills around the Bay Area, out in communities like Walnut Creek, Lafayette, and Concord, attitudes have begun to mirror those in San Francisco and Oakland. "Slow growth and no growth have begun big issues in Walnut Creek and other communities," says builder Page Nelson.

"They stated to develop and then became more sophisticated, and now they have traffic woes. They've limited their downtown growth until they get their traffic straightened out."

That can leave builders with several dilemmas: They may have to scramble to find lots they can develop. They may have to hold onto expensive land if they miscalculate the development climate in a community. And they may have to find some deep pockets to pay the prices sought for land where they can build now.

"The tract builders are going toward Sacramento," Nelson says. "But we can't afford to go out and create \$130,000 homes. Here, we have to deal with the high price of land."

Nelson's niche since moving from remodeling has been single and double

lots. His homes sell for about \$300,000. "We'd like to have \$250,000 to buy land and hold onto it. But we don't," he says. That lack of cash may also mean there's no clout to borrow or attract an investor. "To build their confidence in you, you have to find a project that's ready to turn around. It may take a year or two."

For Bay Area builders, the initial "land" purchase may really be a house purchase. Nelson says: "Our entry was to buy a big, old house and turn it around. Our second step was to buy big lots and build. Next you get a five-or six-lot site that's been subdivided." Lots that are subdivided cost more but carry lower risk.

The key is to know the risks. Nelson says. He doesn't want to buy land that will cost too much to develop or that will get hung up in a zoning fight. That means keeping in touch with local political developments and planning issues. "Your risk goes up a little each time," he says of the three steps. "The risks on large properties are not that they won't sell, but that they may sit a while. An extra six months or a year can kill you."

Without the cash to buy all the land he needs, Nelson looks for investors. "We've got a number of contacts with people who are interested in putting in \$10,000 to \$20,000 if, in a one-to-two year scenario, they can get a 15% to 20% after-tax return," he says.

There's one drawback to taking on investors: "You give up equity in a project. You say, 'It's worth this much in return for your investment.' It's money out of the builder's pocket."

And there's a big advantage: "We don't have a note with them." The investor's money is in the project, sink or swim; he shares the risk.

Given the choice between borrowing from the bank and selling equity shares to investors, Nelson would rather borrow: "If you're in good with a bank – if you know what you're doing, you do it well, if you have confidence in the market and know the market – go to the bank and use some leverage." When he wants to borrow but doesn't have the cash he needs for his equity share, he gets creative. "We can go to our investors and come up with the equity," he says. ■

Gary Mayk is editor of the eastern edition of the Journal of Light Construction.