

No time out for builders

Down-market home prices could be alluring, but buyers should be prepared to move fast

By Roger Showley

STAFF WRITER

October 21, 2007

The fourth quarter of the year had hardly begun Oct. 1 when home builders and industry experts wrote it off as a disappointment and gloomily predicted 2008 won't be much better.

However, what's bad news for builders may be good news for savvy buyers.

“Coming up on year's end, I guarantee that in December you'll see some of the best deals that you'll see all year,” said industry consultant Jeff Meyers.

A veteran watcher of the building industry with offices in Orange County and a home in North County, Meyers said buyers will be able to get 10 percent to 15 percent discounts off asking prices at certain projects. But they must be ready to close escrow without contingencies to meet the end of builders' fiscal years, which can range from Oct. 31, Nov. 30, Dec. 31 or early into next year.

Meyers said the availability of deals also depends on whether it's a private company – which can take its time to sell at target prices – and a public company, with shareholders and analysts demanding greater profits every quarter.

Judging by recent sales campaigns, it's the public companies that are desperate to sell, even at a loss.

But even then, the outlook for builders isn't promising, as BusinessWeek's recent cover story depicted with the headline, “That Sinking Feeling.”

“You've got to go back to the early 1980s when it was that bad – and it took four years to work that off,” securities analyst Jeffrey Laverty told the magazine. “I don't agree that there's a turnaround in sight. It's ugly out there.”

In short, the rose-colored glasses so many builders wear in this risky, entrepreneurial business have been replaced by bifocals, as optimism gives way to realism and executives retrench.

Paul Tryon, chief executive of the San Diego Building Industry Association, said local builders knew back in July and August, when the credit crunch spooked investors and buyers, that 2007 would end up as a bummer.

“I think there was more optimism for 2008 until the latter part of the summer, he said. “Then, traffic was down, sales were down, cancellations were up and people who put deposits in were electing to stay on the sidelines.”

Since October to December is traditionally a slow sales period, Tryon said builders now are just hoping to generate cash and redeploy resources for the future.



JOHN GASTALDO / Union-Tribune

In Escondido, The Briars at Eureka Springs is one of several Lennar developments that offered up to \$70,000 in discounts and incentives in a special weekend sales campaign. Prices start in the mid-\$500,000s on floor plans of 2,750 to 3,198 square feet.

Meanwhile, he said, offices are closing or consolidating, staffs are being laid off and companies cling to hopes of hanging onto their undeveloped lots, which took so long to entitle through San Diego's highly regulated land-use system.

“I think it's both good and bad,” he said, that it is so hard to build housing here. “The upside is, we have a very limited amount of projects in the development pipeline, pending approval. We don't have a lot of inventory by comparison with most metropolitan areas in America, so those assets remain very valuable.”

The bad news, he said, is that housing will remain unaffordable to many would-be buyers and prices are unlikely to slump enough to make a big difference.

“Long-term, if you look at the San Diego marketplace, if consumers are waiting for the bubble to outright burst, this is a very controlled, stable market,” he said.

For Mike Railey, 44, hope outweighed fear as he closed escrow early this month on a \$1.4 million, 1,500-square-foot penthouse at The Legend, Bosa Development's 180-unit condo tower next to Petco Park.

He and his wife, Denise, and their two sons, Dillon, 16, and Baylen, 11, live in a modest home in Del Mar that carries a negative-amortization loan. As a mortgage broker, Railey knows the risks of a loan on which the balance grows if you don't pay enough per month.

“I'm scared right now; I'm struggling a bit,” he said.

And now the family faces an additional \$6,100 monthly payment for the mortgage, taxes and homeowner fees for the downtown unit with a breathtaking view of San Diego Bay. He briefly considered backing out of the purchase until Bosa told him he could risk losing his 15 percent down payment.

“I've done good in San Diego,” he said. “I barely make enough to survive, but with my real estate I can hang in there.”

He hopes to lease the unit out for the time being and bank on an invention he's marketing – a motorized surfboard – to boost his earnings and stabilize his future.

“That gives me a little confidence,” he said.

Confidence is what's lacking among consumers and builders, according to the latest polls. San Diego's unemployment rate is up, job growth has slowed to a crawl and asking prices are falling at many open houses and subdivision tracts.

Robert Kleinhenz, deputy chief economist at the California Association of Realtors, said buyers continue to have problems getting home loans at favorable rates, as lenders tighten underwriting standards in the wake of high foreclosure and default rates.

“The credit crunch that emerged in July continues to be a constraining factor getting buyers into a position where they can consummate a deal,” he said.

Major home builder Lennar Corp., which according to *BusinessWeek* has a 56 percent drop in total returns year to date, is advertising up to \$70,000 off at local projects including its 80-lot Eureka Springs development in Escondido.



CHARLIE NEUMAN / Union-Tribune
Jeff Meyers and Ada Kaiser predict the best bargains at new housing projects will offered by year's end.



EARNIE GRAFTON / Union-Tribune
Denise Railey and her son Baylen checked out their new downtown penthouse at The Legend, overlooking Petco Park. The family lives in Del Mar and hopes to rent out the condo to cover the \$6,100 monthly carrying costs.

According to the Hanley Report's weekly survey at the end of the third quarter, there had been 41 sales and five homes were available in the \$552,000-\$570,000 price range.

Horace Hogan II, president of privately owned Brehm Communities, said while his company may not face the pressures of a public company like Lennar, it is following a similar strategy.

"We don't want to start houses without buyers lined up," he said. "We're seeing our production cut back to bring supply and demand into balance. It's going slowly."

However, expressing more optimism than most, he said Brehm still plans to open a large-lot development in Jeffries Ranch in eastern Oceanside about a year from now.

"The housing market has a strong potential for the second half (of 2008)," he said. "The good thing is there's no recession, and it doesn't appear there's going to be."

Executives of several publicly traded home builders with operations in San Diego County did not return phone calls from the Union-Tribune for comments on their year-end strategies.

Peter Dennehy, senior vice president of Sullivan Group Real Estate Advisors, said the steps taken so far by many builders need to be more aggressive if they want to clear out unsold inventory and beef up their balance sheets.

"Price discounting has to become more noticeable," he said, calling auctions, weekend sales and five-and six-figure incentives "last ditch efforts" to close out the final few units in many tracts.

Looking to the future, he predicted that new projects are likely to be started by local and regional infill developers since national firms cannot generate the quantity of sales expected by Wall Street investors. But he said land sellers have yet to cut prices commensurate with the slowdown in construction.

"The bottom line is we still have too many active projects in the county for the level of sales," Dennehy said. "The level of sales remains depressed. If they're trying to move inventory, price is the generally best way to go."

Jim Abbott, whose downtown Prudential Realty office is helping the Railey family deal with its high-priced penthouse, said so far most builders are reluctant to cut.

"Do they become like Steve Jobs with the iPhone and go back and give everybody a credit? What do you do as a developer? They're in a very tough situation," Abbott said. "You could almost feel sorry for one."

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