

# MARKET UPDATE

*Focus: Residential Land*

April 2011



## Prices Slip, Builders Blink

There is little positive news to report in early 2011. From late 2009 through mid-2010, builder demand surged in primary market areas amid apparent new home price stabilization and reduced lot inventories. With lots acquired below replacement cost, most builders began constructing modest-quality homes designed to maximize affordability and directly compete with the resale market, which remains dominated by real estate owned (REO) and short sales.

But then new home prices began to slide, again, for a combination of reasons. The new home buyer tax credit expired. The initial on-the-fence pent-up demand was quickly absorbed. Resale distressed inventories did not subside. Builders found themselves fighting for a pie that could only be divided so many ways. Making things worse, some national (or public) builders opened projects on lots acquired in 2009 that, up until recently, had performed well enough to not qualify for land impairments (method of writing down land value for accounting purposes). Recent declines may lead to future land write-downs by these builders, leaving another round of home price declines on the horizon that many regional builders will not be able to match.

NOTABLE 2010 TRANSACTIONS		
Location	Description	Price
Madera County	2,225 acres planted with orchard and approved for master planned community	\$30+ Million
Sacramento	577 acres approved for master planned community	\$25+ Million
Placer County	400 acres of speculative land	\$10+ Million

LAND PRICE TRENDS: PRIMARY MARKET AREAS				
Type	Trend	Location	Price	Date
Finished		Clovis	\$72K/Lot	Nov-10
		Roseville	\$95K/Lot	Dec-10
		Stockton	\$35K/Lot	Oct-10
		Napa	\$100K/Lot	Dec-10
		Redding	\$72K/Lot	Feb-10
		Sacramento	\$55K/Lot	Jul-10
Unimproved w/ Infrastructure		Roseville	\$40K/Lot	Jul-10
		Fresno	\$17K/Lot	Feb-10
		Sacramento	\$8K/Lot	Jun-10
Unimproved w/o Infrastructure		Roseville	\$28K/Acre	Aug-10
		Woodland	\$41K/Acre	Jun-10
Speculative Land		Placer County	\$15K/Acre	Dec-10
		Placer County	\$25K+/Acre	Aug-10

*Note: Prices are approximated*

The recent price declines are difficult to measure because so few transactions are occurring. The limited data available and broker interviews suggest year-over-year finished lot values are down 15% to 25% in the Sacramento region and 10% to 15% in eastern and northern Bay Area commuter submarkets. In the Central Valley, builder lot prices have held steady in Fresno, Clovis and Visalia. The strongest housing markets in California are located in Southern California; namely Orange County and San Diego. Here, finished lot values are generally up 10% to 15%.

Despite the recent declines, builders cautiously remain interested in buying lots in primary markets.

## Tertiary Markets

Speculators continue to drive demand for lots in secondary and tertiary markets. Year-over-year finished lot prices in rural towns like Lemoore,

Dinuba and Madera experienced around 10% increases due to dwindling investment supply. Current prices, however, remain substantially less than replacement costs.

Some speculators have also acquired unimproved lots in tertiary markets with the intent to generate interim income from agricultural uses, with the hope to resell 10 to 15 years into the future as speculative land. For certain agricultural property types, land values have increased slightly due to growing investment demand and rising commodity prices.

In unique situations builders have entered into tertiary markets and acquired finished lots at investor pricing. These situations may include builders looking to offer homes eligible for USDA financing (such as Bennett Homes with projects in Northern California) or builders simply looking to capitalize in markets with limited new home competition (such as Florsheim Homes, Wathen-Castanos and Lennar in the Central Valley).

### Product Efficiency

Construction costs are generally down 25% from peak levels. Much of these declines are attributable to increased builder efficiency, including materials/labor reductions, simplified floor plan design and fewer plans offered. Compared to 2010, construction costs have been stable to slightly rising, with slight increases

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*Finished and partially finished lots in Lemoore, CA, acquired by Lennar in February 2011.*

reported for lumber and copper. Also, gasoline price increases may lead to higher delivery costs down the road.

### Other Forces at Work

Even though builders may have priced their product competitively with the resale market, builders have become especially sensitive to distressed sales influencing appraised values when trying to close a deal. According to one Sacramento homebuilding executive, “We have willing buyer, willing seller, and we can’t get the deal done because the appraised value comes in too low. This happens over and over again.”

The level of distress is market specific. For instance, in March 2011 distressed sales represented 51% of all resales in a north Fresno zip code, while in a south Fresno zip code, they represented 64%. In some areas, distressed sales may represent 80% of all resales. If there is limited new home construction, a builder will have an uphill battle trying to achieve prices much higher than the distressed sale prices. As construction continues and distressed inventory subsides, the difference between distressed and market pricing should widen.

LAND PRICE TRENDS: SECONDARY/TERTIARY MARKET AREAS				
Type	Trend	Location	Price	Date
Finished		Coalinga	\$13K/Lot	Jul-10
		S. Stockton	\$12K/Lot	Jul-10
		Oroville	\$10K/Lot	Dec-10
		Arbuckle	\$12K/Lot	May-10
		Dinuba	\$18K/Lot	May-10
		Hanford	\$15K/Lot	Dec-10
		Lindsay	\$22K/Lot	Jan-10
Livingston	\$16K/Lot	Apr-10		
Unimproved w/ Infrastructure		Merced	\$23K/Acre	Sep-10
Unimproved w/o Infrastructure		Tulare	\$15K/Acre	Jul-10
		Porterville	\$13K/Acre	Jun-10
		Dinuba	\$7K/Acre	May-10
		Hanford	\$15K/Acre	Dec-10
		Red Bluff	\$8K/Acre	Jan-11
Speculative Land		Colusa	\$7K/Acre	Mar-10

*Note: Prices are approximated*

### Becoming Creative

With a dwindling supply of deeply-discounted lots in “A” markets, some builders have looked slightly outside the box for bargain bin prices. In Folsom, two separate building groups acquired commercial land with the intent to rezone to residential use. In Placer County, builders have sought distressed projects in Granite Bay, Loomis and Auburn that were originally designed for custom homes. In some cases, the lot sizes are significantly larger (e.g., two acre lots) than what is ordinarily expected for a production home. At this time it is unclear how builders will establish their pricing in light of the larger lot sizes and whether home buyers will pay more for the larger lots under current market conditions.

### Rolling Takedown

To mitigate risk under the present environment, some builders have opted for options or rolling takedown agreements with sellers. Such

agreements enable builders to cut their losses should conditions warrant. In Roseville, a national builder made headlines in mid-2010 when it opted to forego over \$500,000 in option payments (amid market declines) rather than close escrow on its planned takedown. Also, when banks are sellers, they are beginning to welcome rolling takedown arrangements. In mid-2010 a national builder entered an agreement with a lender-seller to acquire 50+ lots in Roseville, and so far the builder has taken-down approximately two groups of 15 lots.

### New Land Foreclosures

Some investors acquired lots in 2007 and 2008 with borrowed capital. Even though the prices may have been below replacement cost, some properties have not been able to attract builder demand, and with notes coming due soon, some of these investments are in danger of foreclosure. In one case, an investment company acquired 71 unimproved lots in Galt in 2008 and lost the property through foreclosure in early 2011.

### Investor Returns

In primary market areas, investors that acquired lots in 2008 and 2009 have been able to achieve healthy returns. The table below illustrates two cases.

FINISHED LOT PRICE INCREASES - INVESTOR VS. BUILDER SALES				
Property/ Location		Initial (Investor)	Subsequent (Builder)	Implied IRR (Annual)
Elk Grove	Price/Lot:	\$43,000	\$73,000	32%
Sacramento Co.	Date:	11/2008	7/2010	
Sacramento	Price/Lot:	\$19,000	\$35,000	30%
Sacramento Co.	Date:	12/2008	1/2011 (offer)	

## Tentative Subdivision Map Extensions

State legislation (SB 1885 and AB 333) passed in 2008 and 2009 extended tentative map expiration dates from two to three years for eligible properties. Tentative maps approved before July 16, 2005 and after January 1, 2009 are ineligible for either extension. With municipalities commonly approving maps with two to three year terms, many maps that were initially scheduled to expire in 2008 or 2009 will now expire in 2011 unless property owners (commonly banks that foreclose) apply for a map extension (commonly three to five one-year extensions) or unless there is new State legislation. Or, if significant offsite and public infrastructure improvements have been expended, final map may record for a “phase,” where the tentative map may be extended two to three additional years. The definition of “phase” varies by municipality. In one city, the definition of “phase” is five or more lots.

*“Overall the market remains soft but certain submarkets are beginning to stabilize.”*

## 2011 Outlook

The prime sales season of 2011 has not yet presented itself. While there continue to be promising signs that a recovery is forming, the market has not yet entered into a recovery cycle and there continue to be negative pressures on sale prices and absorption rates. Sales rates in certain markets have at times been promising. However, so far buyer demand has lacked any

sustained substance that would support a clear upward trend. Overall the market remains soft but certain submarkets are beginning to stabilize. Builders will continue to acquire lots in 2011 but will pay close attention to price and competition. Finished lot prices are not expected to be bid up by builders in 2011 like in 2010.



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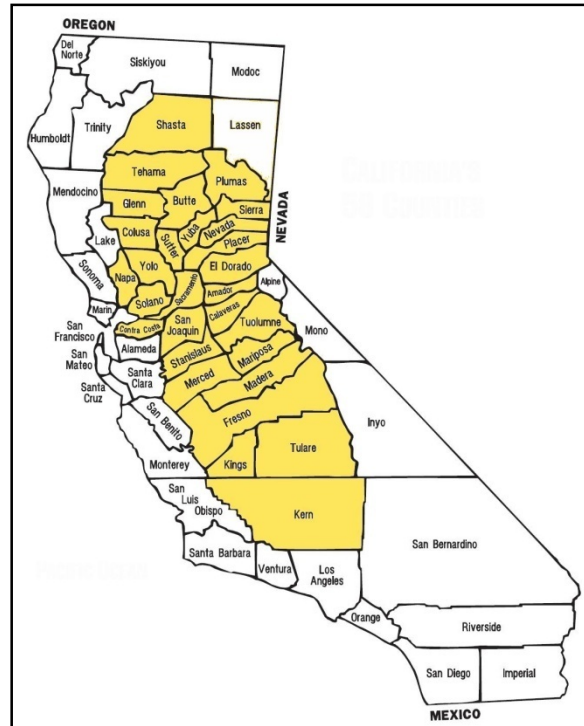
*Note: In this newsletter, the term “finished lot” means all site development is completed, final map has recorded, and all development fees due at final map have been paid. A finished lot does not include fees due at building permit or development fees deferred to close of escrow on homes, since these items are associated with home construction. The definition of finished lot utilized herein is shared by market participants in the Northern California and Central Valley regions.*

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## About Seevers Jordan Ziegenmeyer

Seevers Jordan Ziegenmeyer (SJZ) is a commercial real estate appraisal and consulting firm located in Rocklin (Sacramento metropolitan area). SJZ services California markets from Redding to Bakersfield. Service areas include:

- General commercial (retail, office, industrial)
- Mixed-use and special-purpose
- Land and subdivisions
- Master-planned communities
- Portfolios
- Community Facilities Districts (CFDs) and Assessment Districts (ADs)
- Right of Way
- Partial Acquisition



*SJZ Primary Coverage Areas*

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