Builder News Magazine

Homebuilding Forecast 2010

Written by BN staff | | |

Our annual forecast piece this year is a bit different than in the past. Instead of being a newsy look at what we believe the new year will bring, we're offering an expert-driven look at the industry. Think 2010 will be the year of the rebound? Depends on whom you ask—and we asked a handful of experts, analysts, planners and homebuilders to weigh in on what 2010 will bring to our industry and how (or if) we can possibly climb out of the hole known as 2009.

Two questions we asked were:

1. Where do you see the homebuilding industry headed in 2010?
2. How can we get the industry back on track?

The answers we received were insightful, interesting and knowledgeable. Some were longer and in-depth, while others got straight to the point. Regardless, each answer gives a glimpse on where some of the industry's biggest thinkers believe we'll be heading in 2010.

Glenn J. Amster, shareholder at Lane Powell PC

It's hard to conceive of an industry that has suffered more than real estate in the past 12 months. (OK, maybe automakers, but remember: no bailout here.) Between job losses, the scarcity of credit and, frankly, their own market miscalculation, those in the real estate industry have seen boon turn to bust in a hurry. Unfortunately, they may have to wait until 2011 to see the pendulum swing back in a favorable direction.

Housing prices will continue to decline as foreclosed properties flood the market and credit facilities lag in their return to normality. The wave of homeowners who took advantage of Option ARMs in 2005 to 2007 are going to need to refinance their homes, with the first wave coming in 2010. They will face some hurdles, including increasingly stringent underwriting and higher equity requirements.

Apartment owners experienced a reasonably stable 2009, as an increasing number of people were pushed out of the residential real estate market into rental housing. However, the market should trend toward homeownership because of low interest rates, oversupply of housing inventory, decreasing prices and federal tax incentives. The boom also saw apartments strategically converted to condos. We're now seeing those empty condos being converted back to apartments, contributing to increasing vacancy rates.

The condo market is not expected to return for some time, perhaps not until 2015 or later. But this forecast may be tempered as commute time, commute costs and greater focus on the value of personal time, drive occupancy decisions to denser, condo and apartment-dominated neighborhoods. Look for state and local governments to encourage this migration towards transportation corridors to maximize infrastructure investments and reduce the carbon footprint of the built environment.
Jobs and economic opportunity are the factors that drive housing markets. People want to live in communities where there are jobs. In today's economic climate, with job losses at near-record levels, you will not find any locale where housing demand exceeds supply. Instead, you will find the highest foreclosure rates in those areas with the highest unemployment. To return the real estate industry to its feet, federal, state and local governments need to focus on economic growth: more jobs translates into more housing demand, initially filling built-up vacancies and, ultimately, returning prices to a level that will stimulate new investment in residential real estate.

At the same time, some semblance of normality will need to return to the credit markets. Undoubtedly, developers and homeowners will need to "put more skin in the game", i.e., increase their equity stake in their new home or development project. But expectations should not be unrealistic. First-time home and trade-up buyers will be unable or unwilling to produce substantial equity when job security is at an all-time low and existing investments have lost substantial value.

Appraisers need to be given the latitude to weigh comparable sales. For example, though investors with cash are returning to the real estate market, most are looking for bargains rather than new, speculative projects. This will tend to skew comparable sales downward in the short term, but should not drive valuations for long-term loan purposes. Regulators will need to tread carefully. The industry needs financial institutions to regain confidence in the real estate market. And while greater oversight of lending practices is inevitable and even wise, overzealous regulation could delay recovery for quite some time.

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Bob Cardoza, CCAM, executive vice president, sales & marketing, MERIT Property Management, Inc.; president, MERIT Association Services, Inc.

I expect the building industry in 2010 to mirror that of the past few years. Builders and developers need to make significant efforts to sustain communities that are currently in the development stages and are active in the sales process. I want my builder and developer clients to understand that if they focus solely on future buyers and not on those who currently live in communities and are experiencing significant association operational challenges, their brand and reputation are at stake.
In 2009, association operational challenges included the loss of knowledgeable association board of directors and an increase in delinquency among homeowners as

well as high foreclosure rates. Community financial issues are most significantly impacting the homeowner's quality of life and the value being provided to their communities through their association.

Builders and developers who are facing these realities early on, with creativity and open, transparent interaction with the community association leadership, are combating these potential public relation nightmares most effectively and thus mitigating the negative impact to their company brand and overall homeowner satisfaction.
Lending institutions are now focusing more than ever on associations operations, financial stability, owner occupancy rates and overall governance during the evaluation of a loan within a community association. Whether or not a particular association has been effectively managed and operated will most assuredly be a detriment to the sale process or play an integral part in the successful sale of a home.

One significant factor to the recovery of the new-home sale market is the demand for new homes, which won't fully be achieved until the market is rid of the plethora of foreclosure sale opportunities.

I see a need for builders and developers to re-evaluate the attention and initial planning efforts placed into associations. Those companies who planned communities well are fairing far better in their ability to deal with the potential impacts (both positive and negative) than those companies that did not.

As executive vice president of sales and marketing for MERIT Property Management Inc. and president of MERIT Association Services Inc., Cardoza brings more than 20 years of experience and knowledge in the common interest development industry. He is a member of several state and nationwide industry organizations such as the California Association of Community Managers (CACM), the Building Industry Association (BIA) and the Urban Land Institute (ULI). meritpm.com

<u>Dr. Bill Conerly, principal of Conerly Consulting LLC</u>

The homebuilding industry will be depressed in 2010, but not quite as miserable as in 2009. The fundamental problem is the past overbuilding, resulting in too many single-family homes and too many multifamily units. The excess supply was aggravated by weak demand, as immigrant workers returned to their home countries, couples delayed divorce for financial reasons, and young people either took in roommates or moved back in with their parents. The small rebound that is likely in 2010 does not reflect improving fundamentals so much as having fallen about as far as we can fall.

Public policy cannot solve the housing problem. Programs such as the first-time homebuyers' tax credit help the single-family market at the expense of the rental market. However, rentals quickly become for-sale properties when the market turns up. There is simply no way to speed up the population growth and household formation that will turn the market around.

Homebuilders, though, may be able to get their own trains back on track. Although the country does not need more housing in the aggregate right now, there is some demand for new homes. The location has to be right, the price point has to be right, and the product has to be right. Opportunities continue within very narrowly defined “microniches.”

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<u>Sean Davis, Principal, land planning, landscape architecture, Morris & Ritchie Associates, Inc.</u>

The Washington, DC MSA (which runs from Northern Virginia to Baltimore along the Interstate 95 corridor) is poised to experience a moderate housing recovery in 2010. Several key indicators support this conclusion. First, there is continued job growth within the MSA. The federal government continues to grow, including the recently announced “Cyber Command,” which will likely be located in Maryland, around Fort Meade. In addition, the Base Realignment and Closure program will begin building up additional military jobs at both Fort Meade and the Aberdeen Proving Grounds—collectively up to 60,000 new jobs will be realized between both the military expansion and the private sector support system. Second, the majority of the MSA continues to be a “land constrained environment.” State and local jurisdictions tightly regulate land use within the region, which limits opportunities and places a premium on approved development plans. If someone starts a development project today, they will probably not be able to put a shovel in the ground for three years. The available “approved” and “improved” residential lots within the MSA are quickly dwindling, creating a sense of urgency from the homebuilding industry. Third and finally, the region has experienced much less pain than most, if not all, of the remaining country. From unemployment to real estate depreciation, our numbers are clearly off, but not as much as most. It will be easier to pick ourselves up from the recession, as we did not fall as far as our sister states.

In order to keep the train on the recovery track, it will be essential to find reasonable funding sources. There are several projects that meet the current housing demand and are perfectly poised to come out of the ground at the right time, but the developers need to find funding sources for physical improvements. In addition, it will be essential to control further land use controls. During this time of recovery, our legislators need to scale back ambitious “growth control” measures as these will ultimately lengthen the approval processes and add cost at a time when we need to speed things up and make them cheaper. Finally, the development community needs to be careful to not oversupply the market with available product. Fundamentally, if everything that is on the books today gets approved in the next year or two, we will likely be oversupplied again, which could stall the recovery. Hopefully sound financing will limit possible oversupply, but we should all keep our eyes on our competition.

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Michael Maples, Principal/Co-Founder of Trumark Homes

In California core markets, we think there will be an increase in absorption by 2010, and incentives (except lender incentives) will go away. We think appreciation will return to the marketplace in 2011. We think anything over the government back loan limits will still be tough in 2010 and better in 2011. In addition, we think builders will be much more careful about floor plans. In the go-go times, almost any design was sold. Going forward, we think the industry will be listening to the buyers and designing for their needs. In terms of the green movement, it is here to stay. Buyers will expect it, but will not pay very much extra for it. Buyers will be frugal and practical for the next couple of years, but as the economy returns, they will push for more amenities and slightly larger homes again. Lastly, in the height of the market, buyers looked at a home purchase as 70/30 (70 percent investment, 30 percent home) Now, buyers are 30/70 (30 percent investment and 70 percent home).

All real estate professionals need to listen to the buyers. We need to be disciplined about every part of the business (there cannot be any fat or sloppy execution). And, most important, we need to stop overbuilding.

Co-founder Michael Maples has been a managing member of Trumark Companies and related entities since the formation of the residential development arm of the enterprise in 1993. His areas of expertise include marketing research and analysis, as well as entitlement processing and project management. trumark-co.com

Cheryl Steele, partner, Horack Talley

Most industry leaders believe the worst is over for homebuilders and that business will stabilize and gradually improve in 2010. Several recent legislative changes will help. Along with the extension of the $8,000 tax credit for first-time homebuyers, Congress last November enacted a new credit of $6,500 for owners of existing homes who are purchasing a new principal residence after occupying their current one for five of the last eight years. Both types of homeowners must execute contracts by April 30, 2010, and close on their homes by June 30, 2010. This short time frame will create a sense of urgency for buyers who have been hesitant to sign on the dotted line, as these credits will most likely not be extended in the future.

Congress also increased the income eligibility limits for first-time and repeat buyers. The limits are now $125,000 for individuals and $225,000 for married couples. The higher non-conforming loan limit for mortgages insured by FHA, now capped at $729,750 and due to expire in December, was also extended through 2010. Both measures will help more buyers qualify for loans.

While homebuilders scored a victory with the extended and expanded tax credits, the industry will not experience substantial growth without four substantial changes: They are the increased flow of credit for housing production, a resolution of the issues surrounding the appraisal process, modified product lines and the creation of new jobs.

As lenders suffer from the effects of bad loans and foreclosures, homebuilders are finding it more and more difficult to obtain credit for new construction. Government stimulus may be needed to give lenders an incentive to once again extend credit and jump-start new home production.

The ability of buyers to purchase and finance homes is contingent upon those homes appraising for the contractual purchase price. The appraisal community is experiencing difficulty in valuing residences as fewer comparable homes have closed in the past six months, and the ones that have closed have often been sold at significantly discounted prices as the result of short sales. Clarification is needed in home evaluation protocols and the implementation of the Home Valuation Code of Conduct (HVCC) adopted in May of last year. The HVCC controls who can order appraisals and severely limits communication between builders and appraisers. Builders need some input into the home evaluation process for newly constructed residences in communities where comparable sales are not available. However, they should not be able to unduly influence the process to the detriment of the buyers.

To increase sales, builders have started to restructure their product lines by offering smaller floor plans with limited upgrade options. Others are creating value and lowering monthly expenses for homeowners by creating energy efficiency through the installation of Energy Star-rated appliances and higher-rated insulation. Builders will continue to look for opportunities to make homes more affordable, especially for first-time homebuyers, but new job creation is the catalyst the industry needs to really take off in 2010.

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Edward M. Walters, Jr., President of the Walters Group

The good news is that the economy began stabilizing this year, and we've already seen improvement in some real estate sectors. But it's going to be a long and slow process before we experience a full recovery. It will be two to three years before there is any semblance of vibrant growth. Getting the economy to change directions is like maneuvering an aircraft carrier—you wish it were a quick and agile process, but it's going to take time to turn it around.

The largest issue that needs to be addressed in New Jersey is job growth. The job market appears to be heading into a mild recovery which should take hold by the beginning of next year. As a result, the demand for housing will continue to improve. Another issue is consumer spending. Roughly 60 percent of our economy is driven by consumer spending. There's been a drastic upward trend in the national savings rate; it will take time before people transition back to spending. I believe we will see an improvement by mid-2010.

At one point, there was a lot of focus on fixing Wall Street, and now we need to concentrate on fixing Main Street. There are several actions that Congress and our new administration are taking to keep the positive momentum going in 2010. First, the homebuyer tax credit will be extended. It is finally happening—we are realizing that, like many other recessions, homebuilding recovery is critical in helping the country out of recession.

Second, as a tax benefit to aid struggling businesses, the Net Operating Loss (NOL) Carryback Act was adopted, but it was capped for companies with revenues of $15 million or less. The new act has been amended to allow struggling businesses to carry back the losses for up to five years regardless of the company's size.

Edward Walters Jr. is founder and partner of the Walters Group. As a member of the New Jersey Builders Association (NJBA), Walters upholds the promotion, protection and improvement of the building industry. He serves as a guide for the growth of his organization and remains involved in all aspects of the business with a focus on design and construction. walters-group.com.

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