

The Dead Real Estate Market Analysis – Times Have Not Changed!

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Non Sequitur by Wiley Miller



No one orders a real estate market analysis anymore or they are poorly done!

Not the banks, not Wall Street and clearly not home builders. Yet home builders today are feeling the pain that results from a poor or missing market analyses. Wall Street analysts, rating agencies, and their advisors, including the accounting firms that report on the financial conditions at similar companies, do not seem to understand the residential real estate industry. Either that or they have been looking at the wrong data for two years or so.

The following chart summarizes how publically traded home builder stocks have fared this year.

Some home builders' stocks look sick!							
How shares of some home-building stocks have fared in 2007:							
Company	High	Low	Current Price	31-Dec-06	Off high	Off low	YTD change
Dominion Homes (DHOM)	\$ 6.05	\$ 1.42	\$ 1.45	\$ 5.28	76.04%	2.10%	-72.54%
Comstock Homebuilding (CHCI)	\$ 6.92	\$ 1.21	\$ 1.38	\$ 5.75	80.06%	14.05%	-76.00%
Levitt (LEV)	\$ 15.44	\$ 1.91	\$ 1.97	\$ 12.24	87.24%	3.14%	-83.91%
Hovnanian Enterprises (HOV)	\$ 37.58	\$ 9.76	\$ 10.34	\$ 33.90	72.49%	5.94%	-69.50%
Toll Bros. (TOL)	\$ 35.64	\$ 18.85	\$ 22.15	\$ 32.23	37.85%	17.51%	-31.28%
Meritage Homes (MTH)	\$ 47.73	\$ 16.74	\$ 16.71	\$ 47.72	64.99%	-0.18%	-64.98%
WCI Communities (WCI)	\$ 24.20	\$ 4.95	\$ 5.47	\$ 19.18	77.40%	10.51%	-71.48%
Technical Olympic USA (TOA)	\$ 10.87	\$ 0.63	\$ 0.70	\$ 10.17	93.56%	11.11%	-93.12%
D.R. Horton (DHI)	\$ 31.13	\$ 11.63	\$ 11.76	\$ 26.49	62.22%	1.12%	-55.61%
NVR (NVR)	\$ 851.96	\$ 398.96	\$ 436.70	\$ 645.00	48.74%	9.46%	-32.29%
M/I Homes (MHO)	\$ 38.25	\$ 13.45	\$ 14.43	\$ 38.19	62.27%	7.29%	-62.22%
Standard Pacific (SPF)	\$ 30.52	\$ 3.71	\$ 4.44	\$ 26.79	85.45%	19.68%	-83.43%
Pulte (PHM)	\$ 35.56	\$ 12.88	\$ 13.59	\$ 33.12	61.78%	5.51%	-58.97%
KB Home (KBH)	\$ 56.08	\$ 23.79	\$ 25.11	\$ 51.28	55.22%	5.55%	-51.03%
Centex (CTX)	\$ 56.45	\$ 22.25	\$ 22.54	\$ 56.27	60.07%	1.30%	-59.94%
MDC Holdings (MDC)	\$ 60.34	\$ 37.93	\$ 38.26	\$ 57.05	36.59%	0.87%	-32.94%
Ryland Group (RYL)	\$ 60.13	\$ 20.19	\$ 26.15	\$ 54.62	56.51%	29.52%	-52.12%
Lennar (LEN)	\$ 56.54	\$ 20.52	\$ 21.17	\$ 52.46	62.56%	3.17%	-59.65%
Beazer Homes (BZH)	\$ 47.07	\$ 8.00	\$ 9.64	\$ 47.01	79.52%	20.50%	-79.49%
Champion Enterprises (CHB)	\$ 14.59	\$ 7.18	\$ 11.41	\$ 9.36	21.80%	58.91%	21.90%
Brookfield Homes (BHS)	\$ 41.49	\$ 13.50	\$ 16.13	\$ 37.55	61.12%	19.48%	-57.04%

Sources: Yahoo Finance, BigCharts.com as of November 2, 2007

Ouch!

Wall Street analysts who report on these companies and recommended their shares, as well as company management and their advisors, would have to give back a large portion their pay, bonuses, benefits, stock options, etc. to their shareholders to offset the losses that were incurred as a result of overly optimistic forecasts. In fact, New York State Comptroller, Thomas DiNapoli, estimated a 10% drop in Wall Street bonuses this year. With average year to date home-building stock prices down 50% or more, management equity (not to mention job security) would be similarly off. Yet this doesn't come close to the losses incurred in the housing market. Regrettably, many of these losses could have been avoided by obtaining a properly prepared real estate market analysis.

The overall weakness in the residential real estate market was well known going into 2006: demand was falling and an inventory glut was beginning to take place. There is only limited demand at any one time; nevertheless, supply kept coming and the residential property cycle turned down. Current market indicators show that the housing recession will worsen in coming months, which may further impact the underlying value of the assets owned by many of these companies.

As demand peaked, poorly planned additions to supply continued. This was caused by many factors, including incorrect market analysis of potential supply and effective demand. Many inexperienced investors, analysts, appraisers and accountants, seeing the soaring profits in residential development, recommended entering the market in 2004-2006. They purchased vacant land outright, and began construction, thinking that effective demand would remain forever. Prices for land were increasing so fast that developers moved to lock up property without completing the proper market studies. Lenders were all too accommodating for the fee income. Similar to the stock market, investors became speculators in residential development, but lost due to their fear of poor timing and shades of greed.

Compounding the sudden leaps in price was the much slower permit process. Obtaining the necessary permits to develop residential real estate often takes one or two years, and as long as five or six years in certain markets. If one entered into a contract to purchase vacant land in late 2003, the market was in a down-turn by the time all entitlements were obtained. Yet, bankers provided the money and developers continued to move forward, being optimistic opportunists. The result? **A repeat of the 1970's and 1990's debacles in residential real estate!**

It appears that no one, neither Wall Street, company management, their accountants, advisors nor the lenders learned anything from the earlier cycles in real estate development. (Everyone over fifty was fired or let go for youth, many who are still learning. But that's another article.)

A proper real estate market analysis would have predicted the change in market conditions based on analyzing the following factors correctly:

- ❖ Population forecast
- ❖ Estimate number of households
- ❖ Trends in population changes
- ❖ Age of population
- ❖ Segment demand by housing type
- ❖ Segment demand by ability to pay
 - Types of employment
 - Unemployment rate
 - Income levels
 - Purchasing power (credit/borrowing capacity)
 - Cost and availability of mortgage financing
- ❖ Estimate demand for subject-type housing
- ❖ Behavioral, motivational, and psychological factors
- ❖ Inventory and forecast competitive supply.
 - Existing stock of competitive properties
 - Projects in planning and under construction
 - Availability and price of vacant land
 - Conversions to alternative uses
 - Off-market properties
 - Pending sales
 - Availability of construction loans and financing
- ❖ Analyze the interaction of supply and demand.
- ❖ Analyze residual demand.
- ❖ Forecast subject capture.

This list is only a partial catalog of factors that should have been considered by all of the players in the real estate market. Until real estate market analysis is bought back by company management, accountants, Wall Street analysts and lenders, we should expect ratings to be

reduced and dividends to be cut and more losses and loan write-offs to occur in the real estate and banking industry.

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