

Regional Outlook: April 2008
By Will C. White

Looking Forward in Land

The future is now in the land market in Pima County. The decisions and deals that get made over the next 3 years will shape and determine what happens for the next 20 years in Pima County. The activity in Tucson metro over the past 7 years was at a pace that I do not know will ever be duplicated again. There was almost \$2 Billion worth of land that was traded since 2000. We have spent the last few months looking and evaluating what exactly has happened to the land market and why prices have fallen. The bottom line is that in 2005 there were approximately 598 deals done making up +/- \$960,000,000 million of trading. In 2007 there were approximately 307 deals done making up +/- \$500,000,000 million dollars of trading. The volume has dramatically fallen. We can almost be assured that this year will be proportionately less. The best days are in front of us as far as the land market is concerned and I genuinely feel that 2008 will show the bottom of the market in activity and pricing and that demand will pick back up towards the end of this year and into next year. This will stabilize prices and start to get real deals to happen again.

Homebuilder Factor:

The homebuilders' appetite for land in 2002-2005 was insatiable. We could not find them enough entitled developable land. On top of that there were several expansion builders trying to enter the market during that time. This created frenzied competition for lots and started moving prices up quickly. On any given lot deal, owners had 3-5 builders willing to offer cash deals in bulk. Most prices that got paid were artificially inflated because of the demand. The homebuilders knew that they would sell well in the current market and were willing to buy in bulk and pro forma their deals at 25-30% ratios. Along comes 2006-2008. As absorptions slowed, the demand for additional land slowed. If I could pinpoint a pivotal time in the land market it was probably about June of 2006. This is when Beazer and Centex both cancelled large land deals that would have been their entrance into the Tucson market. As sales slowed and homebuilders began to revalue their inventory, prices on homes began to come down. Finished lot value is in direct relation to home price. So as the prices came down, so did the land values. The builders also stopped looking at bulk, cash transactions and started moving towards rolling options and structured takedowns to factor in the risk of slower sales. Slower sales also caused them to stop using ratios of 25-30% and go down to 20%. It is simply a supply and demand formula. When sales pick up, and they will, the builders will be out looking for land to resupply. As more demand comes into play, we will see lot prices move back up. You have to remember that most large builders have not been buying land for the past 24-36 months. I would say that a lot of the large market share builders will have to address resupply of land inventory in the next 6-12 months. When they do, I believe the search will start from infill then head back to the large master-plans.

Timing the bottom:

There are several groups that call us on a weekly basis, mostly from out of Tucson, looking to buy "distressed" deals. There appears to be billions of dollars available to invest in these "opportunistic" deals. All of this money is working to try and time the bottom of our market. Most of these groups want to be buying finished production lots from homebuilders. What is interesting is that there are all of these opportunity funds, but you don't see a lot of closings.

I do think it is good that there is all of this money available to the market. From a land sales standpoint, it should keep things fluid and continue to provide alternatives for land owners that need them. This money has been available for a long time and I think that it is becoming impatient in some cases. If you look at any finished lot deals that were bought over a year ago, they don't look that good compared to where prices are today. I also think that in most cases the deals that are around today won't be as good as the deals that are around at the end of 2008. I think the smart investors will work to time the bottom within six months, because the market will have corrected before anyone realizes it.

Land Value Exercise:

People are trying to understand land and land pricing today. As part of the column I will take you through an exercise that will show what has happened to land prices in the immediate term and why there are little to no raw land deals happening out there. First is a look at finished lot prices and what has changed. In 2005 the new home median price was \$263,000; today it is close to \$200,000. Not only did the median price come down, but the homebuilders are now, in most cases, using a 20% ratio to determine value of the finished lot. 2005: \$263,000 X 25% = \$65,750 Finished Lot. 2007: \$210,000 X 20% = \$42,000 Finished Lot. That is a difference of \$23,750 per lot or 46%. Also when looking at land development deals, the returns are just not there right now. This explains the weak demand for raw land. In 2003 a piece of land could be bought and entitled then sold off as platted and engineered lots in bulk to a builder. This would represent about a 60% IRR and over 100% ROI. In 2006 the same piece could be bought and entitled, but you now would have to finish the lots and sell them on a rolling option to a builder. This represents about a 12% IRR and similar ROI. This simply does not provide enough incentive for purchases in these conditions.

Future Opinion:

For all that are associated with land development and land planning in Pima County, now is the time to think big! The slowdown in the market is giving everyone a chance to catch their breath and take time in planning their projects. All of the deals and all of the planning that takes place over the next 3-5 years will shape the future of this region. We will plan and approve the new master-planned communities that people will call home over the next 10-20 years. We will define the retail and commercial projects that will make up the activity centers of these different areas. We will have a chance to add lifestyle and amenity to new areas of town. This is all dependent on the development community and their willingness to see Tucson through new eyes and to look to the future. There is a large amount of development talent in Tucson and that talent needs to step it up a notch to continue to keep Tucson a vibrant community. There is a large amount of activity quietly happening right now and the future in the land market is very bright.

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