

Land Market Forces Changed Expectations

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By Sarah Yaussi

In the past year, housing's correction has left an indelible mark on the land market. While some investors have gone cold-turkey on real estate assets, those with the stomach to still stay in the game have redefined what they would call opportunities and recalibrated their financial expectations, according to panelists at a "Deals Done: A Who's Who of 2009 Transactions" session during the 2009 Developer Conference in Las Vegas earlier this week.

Gone are the sanguine days of late 2008 when investors were asking for 30% to 35% returns on a land investment. In their place are more reasonable required internal rates of return (IRRs) in the mid to high 20 percent range for land still requiring development investment and in the low 20 percent range for finished lots.

However, while IRR may have been the gold standard for measuring land investment success, more capital players are looking to different metrics to define a home run. For example, Charles Schwartz, a principal with Aventi Investment Advisors, said that from an IRR perspective, he shot for a 24% IRR so that the company would net 19% returns. However, more importantly, he said that he looked to get out of the investment anywhere from three to six times the initial capital investment and always built in a profit incentive for joint venture partners.

Using multiples as a yard stick is becoming more popular as investment horizons are stretching out. Andrew Stark, executive managing director and partner with Cantor Real Estate said that while IRR is still a consideration in his deal evaluation, it's not everything. "Last time I checked, I couldn't go to the bank and get IRRs," he explained. And as investment multiple has found a place at the top of his priority list, his investment timeline has lengthened from what was a standard three to five years to anywhere from five to seven years.

Schwartz also noted that patience was a virtue in doing good deals, especially in today's environment; in fact he said he was content to "mow grass for seven years" on a real estate investment.

All of the panelists noted that despite the distress in the market, getting deals done is a challenge. Schwartz said he's closed on only two deals this year although he and his partner had fielded more than 1,200 calls about potential opportunities.

And the land deals that are closing look very different than what had been typical for the market. Although Schwartz, Stark, and Mike Forsum, West region president for Starwood Land Ventures, all said they were looking for deals in the \$5 million to \$6 million range, The Concord Group's Richard Gollis pointed out that the bulk of transaction activity is happening at lower price points. Gollis said that he's seeing a lot of distress deals in the \$1.5 million to \$3.0 million range, which typically include something

like four to five homes under construction, 20 or so finished lots, and anywhere from 30 to 40 blue tops, or partially improved lot.

Session moderator Greg Vogel, CEO of Land Advisors Organization, added that those deals often involve parcels in third-tier locations and investors that he described as "local people with the checkbook in their back pocket." The real "A" locations were going for well above replacement costs and some were in fact seeing a lot of bidders.

Schwartz said he, like other investors, tried to stay away from this type of feeding frenzy for finished or nearfinished lots, fueled by major builders needing to restock land pipelines. Instead he saw more opportunity in purchasing raw and entitled land deals or buying the paper, or debt, on land. Purchasing the notes could be expensive because it had a legal aspect to it, but at the end of the day, "you have an asset that didn't get bid up" compared to purchasing a bank-owned, or REO, property, he said.

All the panelists were sweating the turmoil in the commercial markets and feared that rising defaults on commercial loans would narrow their access to capital. "I think our market is tied to the commercial market," said Stark. "When that trillion plus comes through, who can afford to refinance? Banks will have to write it down. And they will stop lending."

But in the meantime, they were still continuing to look at deals every day. Top picks for metro areas included "the whole state of Florida," Phoenix, and Southern California. Schwartz liked Las Vegas, but Forsum wasn't in agreement. With an East Coast focus, Stark liked New York, Chicago, and Washington, D.C., the latter of which along with neighboring Baltimore also made Gollis's Top-5 list.