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Sullivan Seminars

Spring 2008 – Stay
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Assessing New Home Price Impairments: Striving to Reach a Bottom

Recently we were asked by one of our clients to help assess potential new home price impairments going forward in markets around the nation. To get to this answer, part of our research revolved around buyer incentive and price cuts in 17 metropolitan areas ranging from the Desert Southwest to the Mid-Atlantic Region. We surveyed 240 actively selling new home communities in these markets. In most cases, we contacted at least two projects for each of the top public builders in each market. The projects surveyed were geographically diverse of terms of location within each market and price points. The goal of the surveys was to gauge current buyer incentive levels, general incentive direction trend, if base prices have been reduced, and if future price reductions are expected. While our surveys only covered a small portion of active new projects in each market, the aggregated trends for each market provide some compelling information on the health of the new home market in each metropolitan area.

Florida Markets

Our recent round of surveys covered 10 metropolitan areas in the State of Florida. With the exception of Miami and Ft. Lauderdale, most metropolitan areas in the State of Florida have shown double-digit price reductions from peak price levels achieved in the “boom” years of 2004 to early 2006. Our survey results show that Florida has felt the brunt of the recent slowdown in housing, with nearly 60% of projects surveyed in the 10 metropolitan areas indicating that base price had been reduced in attempts to increase sales activity. A few other survey findings include:

- On average, base prices have dropped 8.5% in the Florida markets we surveyed. In addition to base price adjustments, the vast majority of projects surveyed are still offering some form of buyer incentives (monies for closing costs, options/upgrades, mortgage rate reductions, or off base prices).

What attendees are saying
about the Sullivan
Seminars:

"The Sullivan Seminars are informative, educational and entertaining. Tim has the ability to gather all of the Bay Area market statistics and distill it into practical, useful advice for industry professionals."

- Cheryl O'Connor
VP, Sales & Marketing;
Warmington Homes
California

"In my view, the economic and real estate market information and insight obtained at the Sullivan Seminars allow me to make well informed decisions quickly. Attending the seminars definately give me a competitive edge."

Allen Barbour, MAI
VP, Real Estate
Evaluation Group
The Corky McMillin Companies

- While inventory home incentives are still high (equating to an average of 9.2% of the base price of a home), “build-to-suit” incentives are moderating (down to an average of 5.1% of the base price of a home).

The good news coming from Florida is that nearly 70% of projects surveyed indicated that buyer incentive levels are either stable or decreasing and that over 75% of projects surveyed indicated that they did not expect further base price reductions. While we still believe that the remainder of 2007 and 2008 will be a tough year for homebuilding in Florida, a market bottom in terms of pricing may be close at hand in many metropolitan areas.

Mid-Atlantic Markets

Our recent research in the Mid-Atlantic region focused on the Washington, D.C. and Baltimore metropolitan areas. These two metropolitan areas were “heavy hitters” in the recent market boom, but have slowed considerably since peaking in the 2004 to early 2006 period. Important survey findings:

- Nearly half the projects surveyed in Washington, D.C. and less than 40% of the projects surveyed in Baltimore have lowered base price from peak levels achieved the past two years.
- Based upon our review of pricing data in these two markets, new home prices in Washington, D.C. are off 15.3% from peak levels, while prices in Baltimore are off 8.1% from peak levels.
- Sizable buyer incentive levels are still present in these two markets with inventory home incentives equating to an average of 6.4% of the base price of a home in these two markets.
- “Build-to-suit” buyer incentives currently stand at an average of 7.8% of the base price of homes in surveyed projects surveyed.

These levels of incentives speak to the weakness that is still present in these markets. The outlook for these two markets remains guarded as 55% of projects surveyed indicated that buyer incentives remain in an upward trend. The positive news is that 68% of projects surveyed in Washington, D.C. and all projects surveyed in Baltimore indicated that they did not believe base prices would be

lowered again. Look for fall-out from the mortgage industry to further impact sales and pricing levels in the Mid-Atlantic region in 2008.

Colorado Markets

The Colorado markets of Denver, Boulder, and Colorado Springs are unique in that their “boom” period occurred in the late 1990’s. Since the technology and telecom fall-out of the early 2000’s, housing market conditions in these markets have remained average at best. With that said, it is no surprise that less than 10% of projects surveyed have lowered base prices. In fact, base prices have increased an average of 3% at the new home projects we surveyed. A few other key findings:

- Moderate incentive levels were found in the Colorado markets, accounting on average for 7.9% of base prices for inventory homes and only 4.3% for “build-to-suit” homes.
- Trends in the Colorado markets remain relatively positive with 76% of projects indicating that buyer incentives are either stable or decreasing and 90% of projects indicating that base price reductions do not appear to be in the works at this point in time.

We remain cautiously optimistic that markets in Colorado will be able to avoid the more severe downturns found in other markets around the nation. However, employment and population growth levels are not expected to return to the “boom” era levels of the late 1990’s, which will likely limit the growth potential of these markets. Couple this with a national economy that is moving closer to recession (including slowing in the technology sector) and the Colorado markets are not “out of the woods” yet in terms of avoiding tougher housing market conditions.

Desert Southwest Markets

The Desert Southwest markets of Phoenix and Las Vegas represent the epitome of how former “boom” markets are struggling to find a solid footing as demand for housing has evaporated. After exponential increases in prices and sales levels in 2004 and 2005 (fueled by investor buyers), a lack of demand has led to a cycle of increasing incentive levels and reduced base prices that has resulted in

record high cancellation rates and record high inventory levels. A few key conclusions follow:

- Of the projects we surveyed, 63% in Phoenix and 67% in Las Vegas indicated that base prices have been lowered.
- Prices are lower by an average of 8.0% in Phoenix and 6.2% in Las Vegas. Our review of pricing data in these two markets shows that this estimate appears accurate for Las Vegas, but may be understated for Phoenix (prices are potentially off as much as 19.6% from peak levels).
- Moving inventory homes is the current focus of builders in these two markets, with inventory homes incentives currently at 11.0% of base prices in Las Vegas and 14.3% of base price in Phoenix.

“Build-to-suit” buyer incentives are also relatively high at an average of 6.6% of base prices in Las Vegas and 6.1% of base prices in Phoenix. While the downturn in these two markets has been significant, our surveyed uncovered some positive results with over 53% of projects in Las Vegas and 100% of projects in Phoenix indicating that incentives are either stable or decreasing. This optimism carries over to expectations of future price reductions, with 87% of projects surveyed in Las Vegas and all projects surveyed in Phoenix indicating that prices would not likely be lowered again over the near-term. Many projects in Phoenix indicated that the aggressive price cuts and incentives are finally starting to get buyers back into the market. While some positive signs are emerging in Phoenix and Las Vegas, several challenges will remain in place for the remainder of 2007 and through 2008.

Conclusions

Our research shows that while incentive and price levels appear to be stabilizing in many of the markets we surveyed, the remainder of 2007 and 2008 will be tough for the homebuilding industry. While it appears that incentive levels and price reductions will likely diminish in 2008, this change in the market might come more as a result of builders not being financially able to go lower on pricing than as a result of improving local housing market conditions. We believe the key to recovery will be the reset of land values that will allow new product to enter the market at market appropriate prices.