



Land Banks Make a Comeback

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For as much as land banking fell out of fashion during the housing downturn's early years, as land values plummeted and builders faced up to the land risk they had parked off balance sheet, that trend may be on the verge of reversing. Land values in many key home building markets have found a floor as housing demand has begun to stabilize, driving many of the nation's largest builders to once again consider pursuing land banking deals.

This resurgence in builder interest of late is leading some of land banking's former leaders, many of whom exited the business in the downturn, to start up their financing services once again while new players are gearing up for what would appear to be a piece of the action.

Anthony Botte, a senior vice president at Hearthstone, for example, said a number of the company's home builder clients were looking into setting up new land banking deals, although he noted that no such deals with the company had been inked at press time. Hearthstone, similar to companies such as Acacia Capital, GMAC's ResCap, and Saybrook Capital, was a notable name in land banking during home building's heyday.

"There will be a need for it [land banking]," said Botte. "But it is a matter of pairing pricing with terms."

That growing need stems from a dwindling supply of finished lots in attractive markets and submarkets as well-capitalized home building companies aggressively go after bulk lot deals. At the same time, said UBS analyst David Goldberg, there is little land development activity going on today thanks to capital constraints in the market, which means finished lot inventories are being refilled more slowly than they are being depleted. "Eventually we're going to run out of land," he said.

Land banking allows builders to tie up lots earlier in the development cycle without having to outlay large sums of capital up front for either the acquisition or the development of the land. A typical land banking deal is structured such that a land banking partner purchases a property on behalf of a builder partner, taking in a deposit from the builder to secure the purchase. The builder then agrees to a lot takedown schedule, where he would purchase a certain number of lots at regular intervals for the value of the land plus some fees until the deal was paid off. If the builder abandoned the lot options, the deposit is forfeited.

Moreover, despite signs of stabilization in the housing market, builders still appear to be managing their balance sheets conservatively, focusing on conserving cash and paying down debt or extending maturities. Land banking, while expensive by some standards, allows builders

to continue to lay off risk by keeping land liability off their balance sheets, in turn helping the companies generate better returns on equity and capital.

For Jason Perrin and Tom Banks of Greencrossing Real Estate Cos., builders' need to continue to keep risk off the balance sheet represented a business opportunity. The two former Lennar executives recently launched a new land banking program in California, which Perrin said is generating a lot of interest from national builders.

To date, Perrin said no agreements have been signed. However, he said the company, flush with private equity capital from the East Coast, was prepared to enter into four or five land banking deals in the \$5 million to \$15 million range during the next 12 months.

Perrin also said that in addition to helping allay builder risk in the acquisition of lots, Greencrossing's land banking program offered additional balance sheet protection for builders through the development process. Under the typical terms of a deal, the builder would not only enter into a lot-option contract with the company but also a construction agreement, where Perrin's company would hire the builder as a contractor to finish developing the lots, in effect reimbursing the company for its development costs. The net effect is that the builder holds the horizontal costs of developments, along with the up-front acquisition costs, off his books, Perrin said.

Given the limited availability of acquisition and development loans, particularly for private builders, Perrin said, "On paper this makes sense for the privates." However, he said many mid-size private builders appeared reticent to try to pursue such deals, as either they still lacked sufficient balance sheet strength to absorb the financing costs or were unable to secure the vertical financing needed to complete construction.