

URBANLAND®

WWW.URBANLAND.ULI.ORG • JULY/AUGUST 2010 • \$15.00

**HOME
DELIVERY**
Small-scale solutions



INFRASTRUCTURE
BUS RAPID TOD?

DEVELOPMENT
NEW VALUE RESORTS

CAPITAL MARKETS
PRIVATE EQUITY:
WHAT LIES AHEAD



TBG PARTNERS

New Niche for Homebuilders

WHEN MICHAEL MAPLES, principal and chief executive officer of Trumark Homes, was asked at a recent real estate conference about his company's competitive advantage, the answer was unexpected. "We don't know what we're doing," he said. Not that Maples and his partner Gregg Nelson are new to the business; their residential development firm has been active in California since 1993. But it was not until two years ago that they started a homebuilding operation, and what Maples was saying is that they bring a fresh perspective to the industry.

Trumark Homes is one of a new generation of residential homebuilders breaking ground across America, targeting pockets of opportunity in built-out communities that are close to job cen-

ters, mass transit, or retailers. These builders are not single-mindedly pumping out 5,000-square-foot (465-sq-m) mansions, but rather producing a strategic mix of townhouses and small-lot, detached, single-family homes that hit different price points and homebuyer needs.

The trend toward residential urban and suburban infill is well underway, according to *Residential Construction Trends in America's Metropolitan Regions*, a recent U.S. Environmental Protection Agency report. It found that the number of residential permits in downtown areas and close-in suburbs has more than doubled since 2000 in 26 of the largest U.S. metropolitan areas, and the trend is sweeping many smaller cities as well. The shift toward

urban redevelopment was strongest over the past five years, in spite of the real estate slump, the report says.

Indeed, the tail end of the real estate market collapse has spawned a perfect environment for single-family homebuilders to embrace the promise of urban infill. Depressed land prices, pent-up homebuyer demand, the undersupply of close-in housing, and city officials eager for job creation and new revenue make this an opportune time to enter the housing market in many areas of the country.

"The ideal time to start a homebuilding company is at the end of a major downturn," says Maples. "It gives us great access to talented leadership, aggressive subcontractor pricing, and correctly valued land. It is also an environment of significantly reduced

Colfax Companies worked closely with a married couple about to have their first child to design and build their 2,653-square-foot (246-sq-m), traditional farmhouse-style home in an existing neighborhood in Bayport, Minnesota, just east of Minneapolis–St. Paul (right).



COLFAX COMPANIES

new home communities and fewer homebuilders—thus, less competition. The timing allows us to build in a housing market that is undersupplied with new homes—particularly in constrained markets—as the economy recovers and new homebuyers return to the market.”

These startup companies are small and nimble, not burdened by legacy issues, and are backed by bullish investors. “We’re building a new company, not fixing an old one with bureaucratic systems and broken projects,” Maples said. “The balance of potential has shifted from the large builders to the new builders who are able to respond quickly to changes in the market.”

As a testament to its success, Tru-mark has about 1,200 lots in its development pipeline, representing over \$800 million in future revenue. It has two new single-family-home communi-

ties open for sale in infill locations—High Lights in the Granada Hills district of Los Angeles and Wyeth Cove in Upland, California; Wyeth Cove drew more than 1,000 potential buyers for just 39 homes at its grand opening.

There is a robust market for these urban-style neighborhoods, says Shelley Poticha, director of the newly created Office of Sustainable Housing and Communities in the U.S. Department of Housing and Urban Development (HUD).

“A lot of folks feel now is the time for this higher-density product to really pick up,” Poticha says. “There is a whole

array of studies that shows the demand for this kind of housing represents from a quarter to half of the market today. The supply is so much less than the demand that it is an incredibly underserved market. Even though the rest of the housing market is still stalled, this segment is functioning and actually growing, so it’s natural to see these guys move into this arena.”

New homes are getting smaller. The median size of a new house under construction—which had been running well over 2,200 square feet (204 sq m) from 2005 to early 2007—has been declining ever since and was down to about 2,100 square feet (195 sq m) in 2009, according to the U.S. Census Bureau’s quarterly statistics. A January 2009 survey by the National Association of Home Builders (NAHB) also reported that 90 percent of builders say they are constructing smaller homes now.

“It’s a function of the economy,” says Scott Claymon, principal of Carapace Homes LLC, which he started last year to build new and smaller homes in established neighborhoods in suburban Denver. “We felt the market changing

MacMora Cottages (facing page and left) is a collection of 22 bungalows ranging in size from 1,050 to 1,350 square feet (98 to 125 sq m) near the urban core of Austin, Texas. Sold as condos with landscape maintenance included, the cottages were designed to provide affordable housing to young professionals and empty nesters.



TBG PARTNERS



ERIC FIGGE PRODUCTIONS, INC.

Wyeth Cove (above, right, and facing page) is the only new home community in Upland, California. Trumark Homes is building 39 homes ranging from 1,700 to 2,400 square feet (158 to 223 sq m) at prices starting in the mid-\$300,000s.

... and knew that we had to change the product type and location, as well as our philosophy toward homebuilding.”

Claymon is a financial entrepreneur at heart. Three years ago he also founded Carapace Capital Partners, a private equity firm that has been buying up finished lots in the market. He sees the demand for small homes as price driven rather than as a change in buyer preferences.

“Right now price is more important to most people than square feet and yard space,” he says. “But at some point when the market recovers, the demand for larger properties will return.”

Arthur Nelson, director of the Metropolitan Research Center at the University of Utah in Salt Lake City, is not so sure. His research shows a tremendous supply imbalance, with the lack of



ERIC FIGGE PRODUCTIONS, INC.

small-lot, infill homes and the oversupply of big homes on large lots likely to fuel the need for the former for decades.

“Smaller detached homes on smaller lots in infill areas are a really good niche for private homebuilders and probably very secure even for the long term,” says Nelson, who has studied housing trends for 20 years. “Greenfield development is nice when times are good, but urban infill is more resilient, more affordable, and tends to hold its value longer. There

will be a market for this type of housing until we run out of supply of infill property, which will be at least ten years, and maybe even 20 to 30 years down the line.” This demand will be driven by a swelling tide of empty nesters, young professionals, and young families that choose to live in cities or in the first ring of suburbs, he says.

Austin, Texas, where the population has increased 41.4 percent since 1999 to 1.8 million, has seen strong demand for



ERIC FIGGE PRODUCTIONS, INC.

smaller infill projects with single-family residences accompany that growth, says Brent Spraggins, architect and principal at Austin-based TBG Partners. Despite the recession, property values have remained relatively high, and some residential developers have used the strategy of increasing density to provide a more affordable housing product, he says.

TBG has worked on several such projects with Momark Development LLC, such as MacMora Cottages, an Austin community of 22 single-family homes on two acres (0.8 ha) that range in size from 1,050 to 1,350 square feet (98 to 125 sq m) with price tags of \$130,000 to \$180,000. Selling these detached homes as condominiums makes them affordable to young professionals and empty nesters.

“In Austin, urban single-family house pricing is beyond the median-income family,” said Momark president Terry Mitchell. “As a consequence, condos—our cottages, townhomes, flats—will be the dominant urban housing form in the foreseeable future.”

Another innovative approach to affordable infill housing is unfolding

in Minneapolis–St. Paul, where Wayne Soojian, a former executive with Ryland Homes and K. Hovnanian Homes, recently started building single-family detached homes one-by-one on infill lots. His firm Colfax Companies is small and flexible enough to work with individual buyers to design a home that fits their budget and needs, which he insists is the future of homebuilding.

“Based on 25 years’ experience in public homebuilding, I can tell you our favorite word was no,” Soojian says. “Even in this buyer’s market, some companies are still trying to build their house plan on their lots at [their] price—take it or leave it. But I figure that if you can find a way to say yes more often, that gives you a competitive advantage.”

In the typical Colfax deal, the buyer finds a lot, takes out a construction loan, and pays in installments as the house is built according to the package chosen. Soojian does not have to secure elusive financing to purchase land, and buyers get what is essentially a custom-built home from a production builder wherever they want to live. Colfax homes are priced between \$350,000

and \$450,000, which also makes them affordable for first-time move-up buyers in the Twin Cities.

“Today’s homebuyers are very different from those ten years ago. They are better educated about the process, they go online for answers, and they want to be involved in building their home, and that changes the game,” Soojian says. “This market segment is expanding, and it’s not going to go back the other way.”

Whether or not the healthy market for single-family urban infill housing continues once the economy recovers—and which, if any, of the business models discussed here will prevail—is not certain. However, a recent survey conducted by American LIVES for NAHB found that there is swelling demand for smaller homes with energy-efficient features, and the new wave of young singles, couples with no children, and empty nesters is expected to accelerate that trend.

“The redevelopment of urban and suburban centers continues to outpace greenfield development, suggesting a fundamental shift in the U.S. real estate market,” says Edward T. McMahon, senior resident fellow for sustainable development at ULI. “Not that we’ve seen the end of suburban sprawl by any means. But the best opportunities over the next few decades will be well-designed infill projects, and savvy homebuilders recognize that.”

GENEVIEVE ANTON is the principal of Anton Communications, a public relations firm in southern California specializing in real estate development, finance, and investment.