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Homebuilders weigh land strategies as housing cycle matures

By [Karn Dhingra](#)

As questions emerge as to whether the U.S. housing cycle is nearing a peak, industry observers are taking a close look at U.S. homebuilders' land strategies.

The housing market has seen nearly six years of year-over-year increases in new home starts and home sales, and U.S. homebuilders enjoyed a strong spring home [selling season](#). With consumer demand outpacing supply for new homes and homebuilders enjoying increased pricing power, Mizuho Securities analyst Haendel St. Juste sees the near-term outlook as positive.

However, he noted that the industry faces potential long-term challenges, including rising costs for land, labor and materials; the prospect of more Federal Reserve Board interest rate hikes; and the Trump administration's move to cancel a planned 25-basis-point cut in Federal Housing Administration mortgage insurance premiums.

Lot availability for new construction is constrained, and competition for construction-ready land is high, Carl Reichardt, an equity research analyst with BTIG, told S&P Global Market Intelligence. That leaves homebuilders, many of whom have worked through land they bought earlier in the cycle, to decide whether they should buy land at relatively high prices and hope the cycle persists, or begin returning capital to shareholders, he said.

According to St. Juste, the five homebuilder he covers — [Toll Brothers Inc.](#), [PulteGroup Inc.](#), [Lennar Corp.](#), [D.R. Horton Inc.](#) and [KB Home](#) — are adjusting to a more mature cycle by shifting towards a "land-lighter" model, reducing the amount of land they own versus the land they have options to buy. These homebuilders on average had 6.1 years of land supply at the end of 2016, down from 7.6 years at the end of 2014. The companies aim to hold a three-year supply, he added, which will likely take several years to achieve.

Land supply					Trailing-	2014 est.	Current	2017-2014
Company (ticker)	Lots owned	Lots optioned	Total lots	Optioned lots (%)	12-month closings	year's supply (x)	est. year's supply (x)	change in year's supply (%)
Toll Brothers Inc. (TOL)	33,800	14,000	47,800	29	6,226	8.7	7.7	-12
PulteGroup Inc. (PHM)	94,978	41,752	136,730	31	20,231	7.6	6.8	-11
Lennar Corp. (LEN)	136,989	29,514	166,503	18	27,121	7.8	6.1	-22
D.R. Horton Inc. (DHI)	118,500	108,800	227,300	48	43,075	6.4	5.3	-18
KB Home (KBH)*	35,310	9,161	44,471	21	10,100	7.2	4.4	-39
Simple average				29		7.6	6.1	-20

Data compiled on July 10, 2017.

* Based on estimate using fourth-quarter 2016 ratio owned versus optioned.

Source: Mizuho Securities USA LLC's May 16, 2017, homebuilders research report, based on company reports, Mizuho Securities USA estimates.

"I think it's a bit of a tacit reflection that we're getting mid-to-later cycle," he explained. "I think there's positive aspects of owning the land when things are good, but you want to make sure you are balancing your inventory accordingly for a full cycle."

D.R. Horton recently entered a deal to acquire 75% of residential developer Forestar Group Inc. D.R. Horton CEO and President David Auld said the transaction would accelerate the company's long-term strategy of developing relationships with land developers around the U.S. and boost the option portion of its land and lot positions to enhance operational efficiency and returns, according to a transcript of a deal call.

Morningstar analyst Brian Bernard told S&P Global Market Intelligence he is bit more bullish on the current housing cycle than most observers. Morningstar expects housing starts in the U.S. to reach a peak of 1.9 million in 2019, he said, primarily driven by pent up demand from millennials. Homebuilders have been building on average 200,000 fewer houses per year in the current cycle compared to previous cycles, resulting in a limited supply of new homes, Reichardt said.

Bernard, who covers 20 homebuilders, said some homebuilders have reduced their land supply not because they see weakness in the current cycle, but because they learned their lesson from the financial crisis. Many homebuilders have discussed carrying just two to four years of land supply, allowing them to be more efficient and nimble, he added.

During the previous housing cycle, Bernard said, he rarely heard homebuilders talk about return on invested capital and other shareholder-friendly metrics because they did not think the housing market would crash.

"The housing crisis was pretty bad for most of those guys, and I think a lot of them found religion with that," he said.

Khamile Armhynn Sabas contributed to this article.