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Developer Sells Land Dirt Cheap to Reap Tax Benefits

D.R. Horton Unloads California Parcels, Signaling a Shift Amid Housing Slump

By MICHAEL CORKERY

As it struggles through the housing crisis, home builder D.R. Horton Inc. is unloading land across California at big discounts.

Horton, the nation's largest home builder by unit volume, is jettisoning thousands of house lots in far-flung areas, partly to reap the tax benefits from selling property at a loss.

As builders try to survive one of the worst housing downturns in U.S. history, land buyers and brokers expect more such tax-motivated fire sales of undeveloped land this year. That could set a new low for land prices in California and other troubled housing markets. The sales also could indicate a shift for big builders: from developing huge swaths of land in the exurbs, to building smaller developments closer to metropolitan areas.

Horton two weeks ago sold about 2,000 house lots in Desert Hot Springs, a blue-collar community in the far reaches of Southern California's Inland Empire, for $7.8 million, according to county records. William Shopoff, a land investor who bid unsuccessfully for the property, estimates Horton paid about $110 million for the land before spending to prepare the property for development by grading and installing infrastructure such as sewers.

Horton also recently sold a four-acre parcel in Escondido, near San Diego, for $4.4 million, about 25% of what it paid for the property in 2005, according to the county assessor.

Horton, based in Fort Worth, Texas, declined to comment for this article.

Buyers of some of Horton's land in Southern California include a venture between Foremost Communities Inc. and Starwood Capital Group LLC, which together bought 250 house lots from the builder, according to a person familiar with the matter. The investors plan to hold the lots until the market recovers, this person said. A spokesperson for the venture didn't return a call.

As new-home sales sank to a 17-year low, builders can no longer count on doubling their investments by buying undeveloped parcels, preparing the property and selling the homes on it. Horton, which built nearly 53,000 homes at the peak of the housing boom in 2006, has posted quarterly losses since the April-June quarter of last year.

The fire sales are a silver lining in those clouds. Tax law allows companies to apply losses from land and other asset sales to past profits and reap a tax refund. More sales are expected soon because the companies can apply losses only to profits earned as far back as two years and 2006 was the last profitable full year for most builders.

Horton told investors in June that it expects to receive a tax refund of $519 million over the next two years. At the end of last year, Lennar Corp. pocketed a $200 million tax refund after taking a 60% discount on its sale of 11,100 house lots to a joint venture it formed with Morgan Stanley.

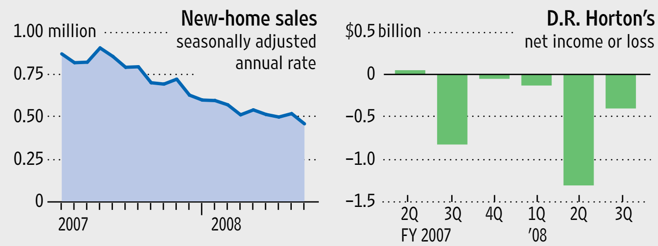
"There's going to be a rash of builders shedding assets," said Tom Reimers, executive vice president of O'Donnell/Atkins, a real-estate advisory firm in Irvine, Calif. "It's all tax-motivated."

By dumping land, builders are chasing cash that allows them to keep current with lenders and pay overhead expenses.

Horton had $851.2 million in cash on hand at the end of its fiscal third quarter, June 30, up from $270 million at the end of last year, according to research firm Zelman & Associates. Horton owes about $210 million in annual interest payments, according to Zelman.

In the Cellar

As home sales have dropped, so have developer D.R. Horton's earnings.



Sources: Census Bureau; the company

Note: Fiscal year ends Sept. 30

So far, most publicly traded home builders have managed to muddle through the housing mess. One reason is the builders' financing arrangements. Many such large companies have long-term corporate debt that doesn't come due for another year or two, giving them breathing room amid the credit crunch. The builders typically don't need lender approval to keep building as long as they honor certain debt agreements at a corporate level.

Most closely held builders, on the other hand, use project-specific financing, in which they need a bank's approval to start each new development. Lenders have completely cut off credit to most small builders, forcing many to file for bankruptcy protection. Analysts expect more than half of the nation's small and midsize builders will fold during the housing downturn, which has already forced such private companies as Levitt & Sons of Fort Lauderdale, Fla., and Kimball Hill Homes of Rolling Meadows, Ill., to file for bankruptcy.

Still, big builders like Horton aren't out of the woods. Horton has $585 million in debt that needs to be paid off in 2009, $362 million due in 2010 and $450 million in 2011, according to Zelman.

Horton's recent land sales also could reflect an industry shift. Over the next few years, builders will likely build smaller developments closer to large metro areas, where house prices are expected to recover faster than in the far-flung regions. That contrasts with 2005, when builders bought massive parcels in California's exurbs and earned big profits as land values skyrocketed during the housing boom.

Horton, for example, is interested in buying 50- to 150-lot parcels that are already developed and closer to certain cities in the San Francisco Bay area, says a person familiar with the company's thinking.

"The builders are going to build in the better locations for the next few years, and live to see another day," said Steve Reilly, a land broker with Prudential Realty in Danville, Calif. "The downside is they are never going to see the kind of margins when lots were doubling and tripling in value in the time it took to build a house."