

THE LAUNCH REPORT
1Q19 NEWSLETTER

SOLVING THE \$250 PROBLEM



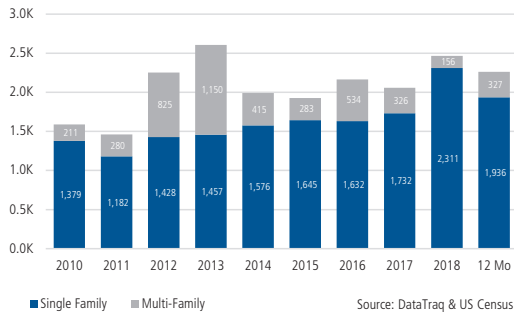
LAUNCH

DEVELOPMENT FINANCE ADVISORS

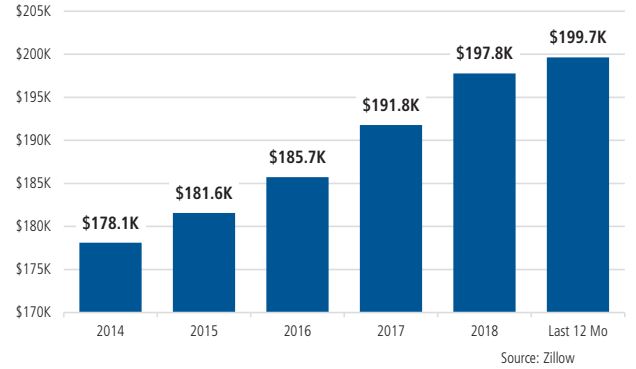


MARKETS AT A GLANCE - ALBUQUERQUE, BOISE, LAS VEGAS (1Q19)

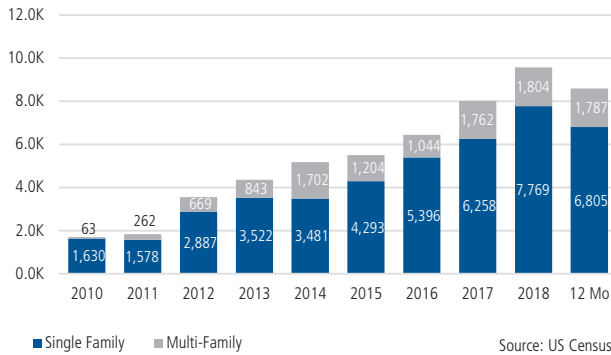
Albuquerque Single Family & Multi-Family Permits



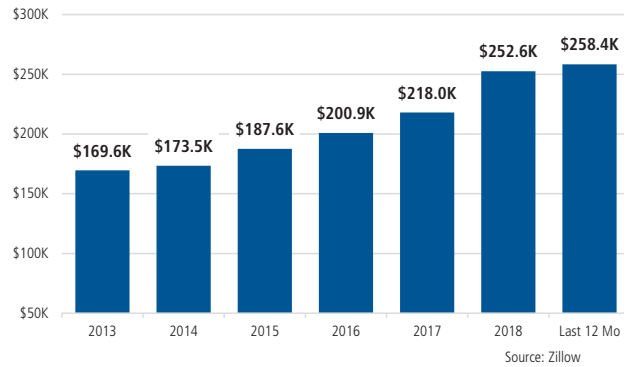
Albuquerque Median Price New & Existing Homes



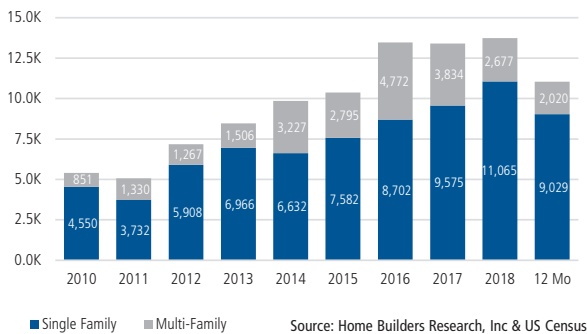
Boise Single Family & Multi-Family Permits



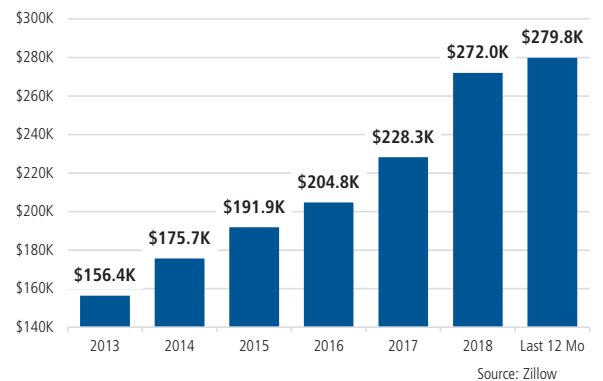
Boise Median Price New & Existing Homes



Las Vegas Single Family & Multi-Family Permits



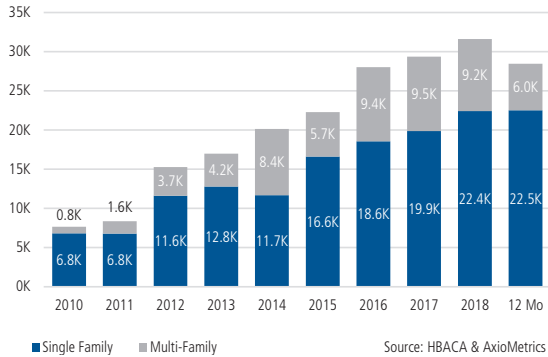
Las Vegas Median Price New & Existing Homes



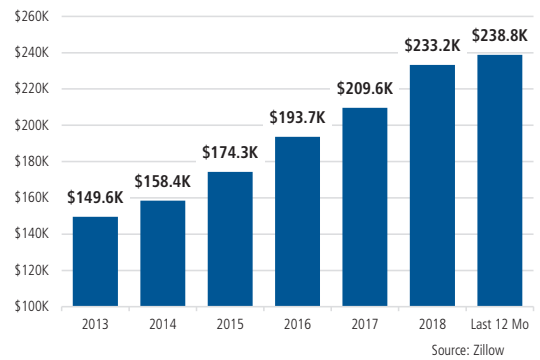


MARKETS AT A GLANCE - PHOENIX, RENO, TUCSON (1Q19)

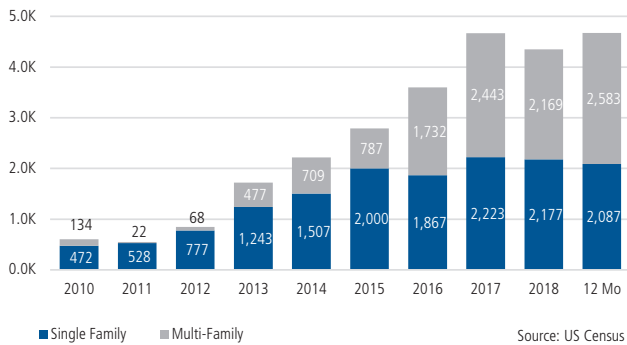
Phoenix Single Family & Multi-Family Permits



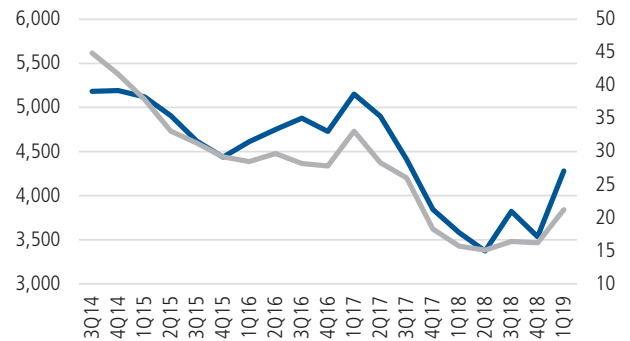
Phoenix Median Price New & Existing Homes



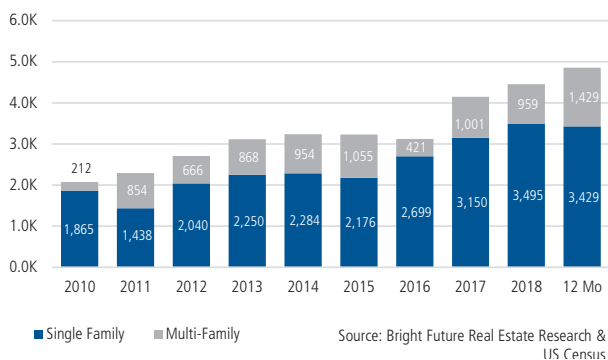
Reno Single Family & Multi-Family Permits



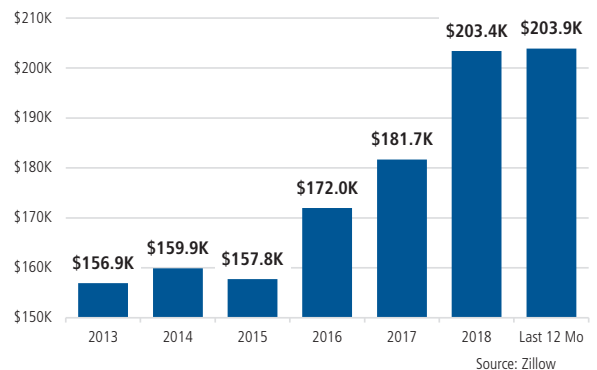
Reno New Home Starts vs Closings



Tucson Single Family & Multi-Family Permits



Tucson Median Price New & Existing Homes





The Guest Corner

This is a new addition to The Launch Report™. Every quarter we'll be featuring an industry leader to give us his or her thoughts related to topics impacting the development industry.

This quarter we're featuring an article from Greg Vogel, the founder and Chief Executive Officer of the Land Advisor Organization, a national real estate brokerage and advisory firm with offices in 22 markets across the United States. Mr. Vogel's article is focused on the "\$250 problem". As this is a huge issue impacting all markets, we dedicated the entire issue to solving the \$250 problem.

The Land and Lot Market's \$250 Problem

By Greg Vogel

New home markets across the US have recovered substantially in price and volume. Historically raw land prices have moved in tandem with an improving housing market. Over the past two years raw land prices have remained stable while finished lot prices have increased dramatically. In past real estate cycles, there was a discernable correlation between the increase in finished lot pricing with that of the underlying platted lot value increase. Currently however, the increase in land development costs have destroyed this paradigm as the increase in lot finishing costs has eroded land value and its potential near term appreciation.

Recently, at a ULI Forum, I was asked to state the one thing that keeps us up at night. My answer was "two hundred and fifty bucks". Everyone looked quizzically while I paused. I further clarified my answer with the "\$250 per front foot increase in the typical lot development cost". I now refer to most of the trouble related to completing "as agreed" builder land transactions as the "\$250 Problem".

While \$250 may appear to be a relatively small amount, on the typical 60 foot wide lot there has been a \$15,000 (60' x \$250) increase in the cost to complete that lot. A finished lot relative to a \$280,000 house would sell for approximately \$65,000 ($\$280,000 \times 23\%$). That same lot now costs \$80,000 ($\$65,000 + \$15,000$) resulting under the standard formula of a \$345,000 ($\$80,000/23\%$) priced home.

How we address the \$250 problem is one of the biggest issues facing our industry.

If a builder or developer optioned land to zone, plat and finish it is a two-three year journey to finish the lots. The initial purchase was approved by land committee or capital partner based on an estimated of the cost to improve. Given the increase in infrastructure costs, many development budgets are broken due to outdated cost assumptions and builders are not able to cover the increase by increasing the home price. While the above example requires a \$65,000 home price increase to maintain a desired lot to home/finished lot ratio, the reality is that \$65,000 could come from multiple sources that include: (i) land owner concessions; (ii) homebuilder margin compression; (iii) buyers paying more for less (e.g. smaller lots/homes and/or fewer amenities); (vi) a reduction in the cost of capital, and/or, (v) the use of special taxing districts.

In the end, we are seeing an increase in the lot to home price ratio due to the inelasticity of land sellers, cost increases and inadequate proforma contingencies stressing the standard financial return formulas.

Sub-market forces of builders with varied lot basis resulting from varying acquisition dates create larger deviations among competing project/products. Lower cost subdivisions have to be sold off in mass to allow for a new stair step of pricing.

To further complicated the situation, jurisdictions continue to increase development standards as well as permits and fees generating additional development costs for the industry.



Enough is enough, but what can be done to address this \$250 issue?

Below are a few strategies, many of which will require government cooperation.

1. Design and build narrower lots (40-50') and add more depth (120-130') to allow variety of product size and address jurisdictional design/density concerns with varied set-backs. The jurisdiction's main complaint with narrower lot product is the monotony of garage dominance. Varied setbacks and product types may assist to partially address this concern.
2. Go further out to buy land more affordably and get ahead of the herd. Align with land bankers willing to warehouse larger unentitled parcels with relative certainty of zoning and platting.
3. Buy larger lot counts to gain scale and development efficiency or option land for future phases to your strategy.
4. Add a home builder/capital partner to increase scale of purchase.
5. Build behind a gate – privatized streets typically require less infrastructure. Be aware however that many jurisdictions oppose gates and sub associations can increase HOA fees.
6. Utilize special district bond financing for Infrastructure – Offset a portion of the increased infrastructure costs with a long term (25 – 30 year term) low cost of capital (4% to 5.5%) that will ultimately be assumed by the homebuyer. This strategy will typically require a larger scale of project (300+ acres) to allow for cost efficiencies related to district financing. This strategy marries well with #2 and #3 above.
7. Persuade the jurisdiction to buy into having less infrastructure such as a sidewalk on only one side of the street and soft surface trail on the other. This will reduce cost and enhance community look and value.
8. Negotiate for guaranteed finishing cost from the lot provider and/or contractor to gain certainty in pricing.

Builder's customary proformas utilized a 10 percent contingency on lot development cost with a preliminary plat and a 5 percent contingency with final engineered, fully bid plans. In today's uncertain cost environment, builders are utilizing a varied range of contingencies. We are finding this varied spread of contingency usage disrupting some builders from successfully contracting for new development projects.

The result of the cost increases is that more-and-more projects are failing the feasibility process. We are being required to sell the same land/lots two or three times in order to close the sale. The failing feasibility rate is resulting in a lack of production exacerbating the chronic shortage of lots in many local and national markets. Developers and their capital providers are finding less room for profit adding to the shortage. The result has been increasing lot prices, stable to slight decline in land value and home prices rising out of reach for many first-time home buyers.

Not is all doom and gloom, there is hope and some evidence that horizontal development costs are beginning to moderate, employment rates are at their lowest rates in 50 years, and builders have shown a willingness to absorb these increase and pass most if not all of the increased costs to the consumer. As an industry however, there isn't a silver bullet that will solve the "\$250 problem"; it will take a myriad of different approaches with all participants in the development process (e.g. land sellers, contractors, builders, capital providers, jurisdictions and home buyers) adjusting their expectations and sharing in the increased cost burden.

*Greg Vogel is the founder and Chief Executive Officer of the Land Advisors Organization.
Contract Mr. Vogel at 480-831-8100 or email at gvogel@landadvisors.com.*



One Solution to the \$250 Problem

By Carter Froelich, CPA

As Greg Vogel outlined in his article "The Land and Lot Market's \$250 Problem", one of the ways that lot costs can be reduced is through the use of special districts. Special districts have many different names (CFD, MUD, PID, SID, CID, etc.) but all effectively serve the same purpose; that of issuing long term, non-recourse, tax exempt bonds to fund public infrastructure. The obligation to repay the bonds is passed on to the end user of the property.

In Arizona, the most prevalent financing vehicle for public infrastructure is the community facilities district ("CFD"). The table illustrates how a homeowner CFD payment of less than \$100 per month can solve the \$250 problem.

As one can see from the table, there are numerous ways to off-set \$250 in public infrastructure costs using a CFD. When engineering the

	Scenario I		Scenario II		Scenario III		
	General Obligation - \$3.00		General Obligation - \$4.00		Special Assessment - \$17,000		
	Special Assessment - \$7,000		Special Assessment - \$4,250				
	Units	Price	Units	Price	Units	Price	
Product Assumptions							
Total EDU (1)	653	\$ 320,000	653	\$ 320,000	653	\$ 320,000	
Property Taxes	Tax Rates	Annual/Unit	Tax Rates	Annual/Unit	Tax Rates	Annual/Unit	T
Current Residential TaxRate	\$ 9.89	\$ 1,900	\$ 9.89	\$ 1,900	\$ 9.89	\$ 1,900	\$
Additional GO TaxRate	3.00	576	4.00	768	-	-	
O & M	0.30	58	0.30	58	0.30	58	
Additional SA TaxRate (2)	2.77	532	1.68	323	6.73	1,293	
Community Wide - Effective TaxRate	15.97	3,065	15.88	3,048	16.93	3,250	
General Obligation Bond Summary (2)							
Bond Amount (3)	\$ 5,301,127	\$ 8,118	\$ 7,068,170	\$ 10,824	\$ -	\$ -	\$
Cost of Issuance	(212,045)	(325)	(282,727)	(433)	-	-	
Underwriter Fee	(106,023)	(162)	(141,363)	(216)	-	-	
Capitalized Interest	-	-	-	-	-	-	
Reserve Fund	-	-	-	-	-	-	
Net Construction Proceeds	\$ 4,983,060	\$ 7,631	\$ 6,644,079	\$ 10,175	\$ -	\$ -	\$
Special Assessment Bond Summary (3)							
Bond Amount	\$ 4,571,000	\$ 7,000	\$ 2,775,250	\$ 4,250	\$ 11,101,000	\$ 17,000	\$
Cost of Issuance (4%)	(182,840)	(280)	(111,010)	(170)	(444,040)	(680)	
Underwriter Fee (2%)	(91,420)	(140)	(55,505)	(85)	(222,020)	(340)	
Capitalized Interest	(251,405)	(385)	(152,639)	(234)	(610,555)	(935)	
Reserve Fund (10%)	(457,100)	(700)	(277,525)	(425)	(1,110,100)	(1,700)	
Net Construction Proceeds	\$ 3,588,235	\$ 5,495	\$ 2,178,571	\$ 3,336	\$ 8,714,285	\$ 13,345	\$
Total Issues							
Bond Amount	\$ 9,872,127	\$ 15,118	\$ 9,843,420	\$ 15,074	\$ 11,101,000	\$ 17,000	\$
Cost of Issuance	(394,885)	(605)	(393,737)	(603)	(444,040)	(680)	
Underwriter Fee	(197,443)	(302)	(196,868)	(301)	(222,020)	(340)	
Capitalized Interest	(251,405)	(385)	(152,639)	(234)	(610,555)	(935)	
Reserve Fund	(457,100)	(700)	(277,525)	(425)	(1,110,100)	(1,700)	
Net Construction Proceeds	\$ 8,571,295	\$ 13,126	\$ 8,822,651	\$ 13,511	\$ 8,714,285	\$ 13,345	\$
Net Construction Proceeds Per Front Foot (Avg Lot Size 53')		\$ 248		\$ 255		\$ 252	
Footnotes:							
(1) Developer estimate.							
(2) General obligation bonds have an interest rate of 5.00%, amortized over 25 years, 4.0% cost of issuance, and 2.0% underwriter fee.							
(3) Special assessment bonds have an interest rate of 5.50%, amortized over 24 years, 4.0% cost of issuance, 2.0% underwriter fee, 1 year of capitalized interest, and a 10.0% reserve fund.							

financial structure of the CFD for your project, it is important to determine the goal of the financing and structure accordingly.

If your organization is not interested in the timing of the CFD bond proceeds and is more interested in the total nominal dollars that are received over time, the use of general obligation bonds should be the focus of the CFD.

If on the other hand your organization is wanting to accelerate the flow of CFD bond proceeds into the project's cash flow to maximize IRR, you should consider the use of special assessment bonds.

While there a lot of other issues to consider when structuring a CFD, the main point of this article is to demonstrate what the development and home building industry can do today to solve the \$250 problem.

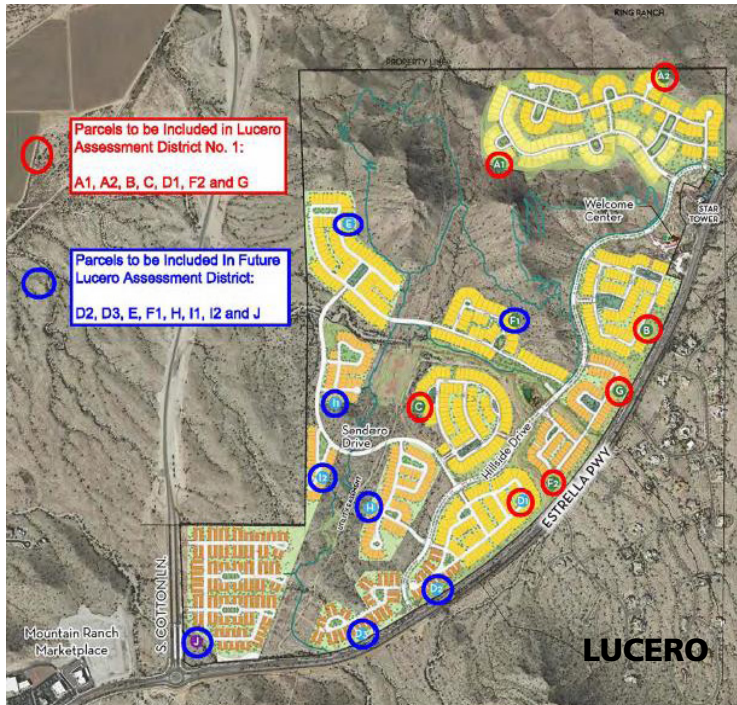
Carter Froelich, CPA is the Managing Principal of Launch Development Financing Advisors. For more information on how special taxing districts may assist in the financing of your project, contact Mr. Froelich at 480-874-4355 or email at carter@launch-dfa.com.



Recent Bond Transactions

By Tim Hilton / Carter Froelich

The following table illustrates some of the bond transactions that the professionals at Launch have been involved.



VALLEY VISTA

Description	Lucero	Valley Vista (1)
Master Planned Community	Estrella Mtn. Ranch	Valley Vista
Jurisdiction	City of Goodyear, Arizona	City of North Las Vegas, Nevada
Developer	Newland Communities	DR Horton, Inc.
District Type	CFD	SID
Assessment Area Acreage	172.21	452
Estimated Units	523	3,689
Estimated Density / Acre	3.0	8.2
Gross Assessment Per Acre	\$ 40,143	\$ 75,077
VTL Ratio	4.86 to 1	3.69 to 1
Estimated Gross Bond Amount	\$ 6,913,000	\$ 33,935,000
Average Assessment Lien/Unit	\$ 13,218	\$ 9,199
Estimated Interest Rate	4.46%	4.21%
Term of Bonds (Years)	25	30
Avg. Annual Assess. Payment	\$ 888	\$ 546

Source: Launch. Valley Vista figures are estimates and subject to change.

Footnotes

(1) At time of article bonds had priced. However, the transaction had not closed, closing date estimated to be June 19, 2019.



Using PIDs in New Mexico to Reduce Increasing Costs

By Pam Giss

Retail lot sales prices in the Albuquerque metro area start at \$1,250 per front foot and most developers are just breaking even on lot sales. Increased cost of land, labor and high borrowing costs make many projects financially challenging. As a result, developers and builders are increasingly turning to public finance tools such as Public Improvement Districts ("PIDs") to offset a portion of the costs of public infrastructure construction. These tools are not limited to the New Mexico market. The most successful projects in the United States are funded in part by special districts similar to New Mexico's PIDs.

A project with 345 lots ranging in size from 55' to 60' could generate an additional \$3.95 million for construction and/or acquisition of public improvements depending on the existing tax rates and competitive market surrounding the project. The table below provides an example of the cost and revenue generation per lot of a PID.

	Public Improvement District Planning Areas 1 & 2						Subtotal/ Wtd. Avg.
	55' x 100'			60' x 110'			
	Plan A	Plan B	Plan C	Plan 1A	Plan 1B	Plan 1C	
Unit Plan							
Estimated Base Home Price	\$ 240,000	\$ 260,000	\$ 280,000	\$ 315,000	\$ 350,000	\$ 375,000	\$ 299,783
Estimated Taxable Value	\$ 79,992	\$ 86,658	\$ 93,324	\$ 104,990	\$ 116,655	\$ 124,988	\$ 99,918
Ad Valorem Tax Rate (30.522 mills)	\$ 2,442	\$ 2,645	\$ 2,848	\$ 3,204	\$ 3,561	\$ 3,815	\$ 3,050
Proposed PID	\$ 918	\$ 995	\$ 1,071	\$ 1,205	\$ 1,339	\$ 1,435	\$ 1,147
Total Annual Property Taxes Collected	\$ 3,360	\$ 3,640	\$ 3,920	\$ 4,410	\$ 4,900	\$ 5,249	\$ 4,197
Property Taxes as % of Home Value	1.40%	1.40%	1.40%	1.40%	1.40%	1.40%	1.40%
Unit Mix	56	65	74	41	57	52	345
Total PID Annual Tax Collections	\$ 51,416	\$ 64,653	\$ 79,267	\$ 49,408	\$ 76,321	\$ 74,600	\$ 395,664
Total Annual Special Taxes for Bonding	\$ 320,098						

	Interest Rate Scenarios	
	4.75%	5.25%
Bond Amount (30 Yr Term, 29 Year Amort.)	\$4,984,531	\$4,714,550
Underwriter's Discount (2%)	\$99,691	\$94,291
Capitalized Interest (1 Year)	\$236,765	\$247,514
Reserve Fund (Annual Debt Service)	\$498,453	\$471,455
Cost of Issuance (Estimate)	\$199,381	\$188,582
Total Net Construction Proceeds	\$3,950,241	\$3,712,708
Est. Avg. Per Unit	\$11,450	\$10,761
Est. Avg. Per Front Foot	\$200	\$188
Est. Avg. Cost Per Unit per Month	\$ 96	\$ 96

In this case, the PID would increase annual property taxes by approximately \$1,150, which equates to \$96/month. After deducting costs of issuance, this provides an additional \$3.71 to \$3.95 million in construction proceeds to reimburse the builder/developer for streets, water systems, flood control systems, drainage and sanitary sewer systems, trails parks, landscaping, lighting systems traffic control systems and other public improvements. In this example, the bond proceeds from the PID generate an additional \$200 per front foot and can make the difference between moving forward with a transaction or killing the deal.

Pam Giss is a Principal at Launch Development Finance Advisors and may be contacted at: (480) 874-4358 or pamelag@launch-dfa.com

THE END TO END ADVANTAGE™

1. Land Purchase (LAO)
2. Planning / Builder Needs Analysis (Launch / LAO)
3. Assist with Entitlements (Launch)
4. Prepare Infrastructure Financing Strategies (Launch)
5. Prepare Pro Forma Cash Flows (Launch)
6. Interim Construction Financing (Launch / LAO)
7. Establish Special Taxing District (Launch)
8. Issue Special District Bonds (Launch)
9. District Admin. / Reimbursement Services (Launch)
10. Sell Parcels to Builders (LAO)



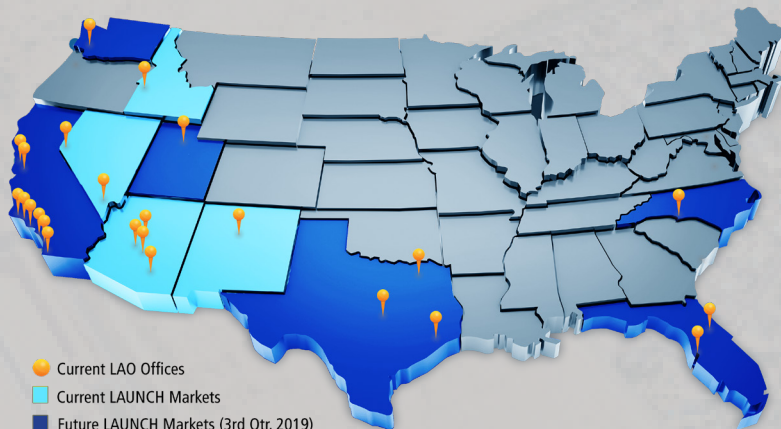
LAUNCH

DEVELOPMENT FINANCE ADVISORS



Land Advisors®
ORGANIZATION

4900 North Scottsdale Road, Suite 3000, Scottsdale, Arizona 85251
480.941.2800 | Launch-DFA.com



SCOTTSDALE, AZ | CASA GRANDE, AZ | PRESCOTT, AZ
TUCSON, AZ | IRVINE, CA | BAY AREA, CA
COACHELLA VALLEY, CA | PASADENA, CA
ROSEVILLE, CA | SAN DIEGO, CA | SANTA BARBARA, CA
VALENCIA, CA | ORLANDO, FL | TAMPA, FL | BOISE, ID
CHARLOTTE, NC | ALBUQUERQUE, NM | LAS VEGAS, NV
RENO, NV | AUSTIN, TX | DALLAS-FORT WORTH, TX
HOUSTON, TX | SALT LAKE CITY, UT | BELLEVUE, WA

