Staying Competitive in Today’s Homebuilding Industry.

U.S. Homebuilder Survey
Deloitte & McGraw-Hill Construction conducted a study of homebuilders with the goal of highlighting the dynamics and challenges that large and small residential construction companies face. Our survey reveals how homebuilders are navigating a strong housing market - not only to drive sales and expand margins - but to keep current on market trends, devise strategies to deal with an increasingly constricted land supply, and adapt business models to sustain the industry’s growth.

Highlights

The housing market has been in a sustained growth pattern since 1992. Perhaps the most notable aspect of this expansion is that, instead of declining during an economic recession, homebuilding, home sales, and home remodeling helped sustain the economy during the recent downturn. The contributing factor to this unusual resilience was a drop in mortgage interest rates to 46-year lows.

The momentum continued through the first half of 2005. Both new home starts and pricing rates continued on a positive trajectory. According to the National Association of Realtors, 4.8 million existing homes changed hands through August 2005, setting the stage for the market to sell a record 7.3 million homes by the end of 2005. And, while the industry’s profit margins have shown no signs of contracting recent fluctuations in materials and fuel costs, as well as other economic uncertainties may lead to slower growth.
In the midst of impressive industry growth it is difficult to take the doom and gloom of a bust too seriously, especially when interest rates continue to remain historically low. Still, some analysts maintain that a combination of rapidly rising inventory of new homes and records for housing starts would indicate the bubble’s impending rupture.

The following chart shows strong stock prices gains for homebuilders over the last several years.

Industry analysts think hurricane Katrina’s impact on building is temporary, despite a spike in nationwide market prices for lumber and plywood. Homebuilders see transportation costs likely to rise because of oil price increases and a tight labor pool should workers relocate when the Gulf Coast cities start to rebuild.

Housing starts over the past five years have been running slightly below the rate set in the 1970s, when the U.S. population was 30 percent lower and immigration rates were 50 percent less than what they are today. In the current climate, a moderate slowdown in certain regions of the U.S. housing market appears more probable than a deep-seated recession in the general housing market.

What are the key questions that homebuilders are asking themselves as they relish the boom and dispel concerns about the bust?

1. What is our plan for growth?
2. As the industry consolidates, will we be acquiring or acquired?
3. What is the best way for us to keep abreast of what is happening in our industry?
4. How do we use technology to improve our efficiency and competitiveness in the marketplace?
5. How can we take advantage of outsourcing services to reduce costs?
6. How do we deal with issues that delay production?
7. When land supply is an issue, how do we adjust our project development?
8. Are we spending too much on land development?
9. How do we reduce our building cycle time, budget variance, and defects?
10. What operational issues can we address to increase our efficiency?
11. Do we need to look elsewhere for home design ideas?
12. Where in our supply chain can we find additional cost savings?
13. Are we prepared for the affect of GAAP reporting under FIN 46?
14. Which marketing approaches will drive the most sales?
15. How do we respond to customer desires relating to home customizations and the environment?
Homebuilding Industry – Sustaining the Recent Success

According to data reported by the Bureau of Census and the National Association of Realtors, there are approximately 120 million homes in the U.S., and about 1.5 million new single-family homes are added to the stock each year.

In 2004, there were 1.6 million single-family homes started (versus 1.2 million sold), and 350,000 multifamily starts. The median price for new single-family homes reached $221,000 in 2004, compared with $184,000 for existing homes. The average size of a home continues to grow steadily, reaching a median square footage of 2,162 in 2004, compared with 1,535 in 1975.

Industry's Significant Factors

The key driver in homebuilding is the level and direction of interest rates. Other significant factors that drive cycles within the industry are supply and demand, pricing, and the availability of rental units. The market is also impacted by employment trends, consumer confidence levels, and housing prices. The availability of mortgage capital also plays an important role in sustaining consumer demand.

Although interest rates and the number of new housing starts are among the most visible factors shaping demand, the structure of the industry itself is the most salient determinant of economic value. Indisputably, the homebuilding industry structure is becoming increasingly attractive. Fundamental long-term demand for housing remains strong. Population growth, real income levels, and the age of households are among the prominent variables likely to positively influence the homebuilding industry over the next few years. Less visible trends include intensifying barriers to industry entry. Complexity of development and economies of scale in capital access and materials procurement are making it more difficult for new players to enter the market. The rivalry among existing competitors is also increasing. Not only are large builders gaining market share, they are competing head-to-head in a growing number of markets.

Land is the Differentiator

Land is the most important commodity in the homebuilding business. Land is becoming increasingly scarce, especially in hot markets, and correspondingly, land is becoming more important to the buyer than the features of the new house alone. The result of these trends is superior profitability in the industry, especially for large regional and national builders. Despite strong consumer demand for housing, the supply of land for home building is limited. Builders are facing a critical shortage of developable land. As a result, the cost of land has soared in many regions of the country. Builders are locked in bidding wars. Local governments are promulgating more and more land use regulation as they attempt to foster “smart growth.” Governments are lengthening the permit approval process, preserving land for conservation, and minimizing residential growth by imposing moratoriums on development. In some markets, three-fourths of home price appreciation growth can be attributed to land-use regulations, according to Fisher Center for Real Estate and Urban Economics Chairman Kenneth Rosen. Regulations are limiting the amount of developable land and increasing the costs of that land.

Industry Consolidation – Threat or Opportunity?

In addition to limitations on the supply of land, business growth and the prospect of consolidation are major issues for homebuilders. When growth is limited in currently served markets due to land restraints or competition, one way to grow is to expand in new markets, by either seeking business in a new geographic area or by taking over another firm in a different region. For dozens of years now, large public builders have been devouring smaller private builders in an effort to sustain pricing power and increase their supply of buildable land. The trend toward consolidation shows no sign of abating any time soon.

The following summarizes the critical issues using information gathered from our survey of homebuilders and lot developers, as well as our continuous monitoring of the real estate markets.
Who We Surveyed

- Homebuilders or lot developers
  97% of our respondents
- Privately held companies
  94% of our respondents
- Annual revenues of greater than $100M
  34% of our respondents
- Build more than 250 homes per year
  29% of our respondents

Respondents by Profession

Revenue Distribution of Respondents
What They Build

Residential Construction by Respondents, by Type

Move-Up 63%
luxury 11%
Other 4%
starter 22%
other 4%

How Many They Build

Number of New Homes Built in 2004 by Respondents

Number of Homes
0% 5% 10% 15% 20% 25% 30% 35% 40% 45%
Under 100 100 to 250 250 to 500 500 to 1,000 1,000 to 5,000 5,000 to 10,000
Respondents
Percent of Homes Pre-Sold

The U.S. housing market is inherently regional, and our survey results reflect the broader nationwide statistics on housing construction. Respondents are building more units in the south and southwest. Hot markets include Phoenix, Las Vegas, California, and Florida.

Where They Build
The Price of New Homes

New homes along the east and west coasts are more expensive than in other areas of the country, regardless of the type of home, whether it is a starter, move-up, or luxury home.

<table>
<thead>
<tr>
<th>Region</th>
<th>Starter</th>
<th>Move-Up</th>
<th>Luxury</th>
</tr>
</thead>
<tbody>
<tr>
<td>California</td>
<td>$358,333</td>
<td>$535,125</td>
<td>$1,596,667</td>
</tr>
<tr>
<td>Northeast</td>
<td>$266,250</td>
<td>$420,667</td>
<td>$995,000</td>
</tr>
<tr>
<td>Nat’l Average</td>
<td>$188,022</td>
<td>$304,792</td>
<td>$855,074</td>
</tr>
<tr>
<td>Midwest</td>
<td>$172,143</td>
<td>$284,647</td>
<td>$502,727</td>
</tr>
<tr>
<td>Northwest</td>
<td>$167,600</td>
<td>$261,000</td>
<td>$650,000</td>
</tr>
<tr>
<td>Southwest</td>
<td>$141,167</td>
<td>$207,429</td>
<td>$945,000</td>
</tr>
<tr>
<td>Florida</td>
<td>$136,667</td>
<td>$298,889</td>
<td>$743,750</td>
</tr>
<tr>
<td>Texas</td>
<td>$131,400</td>
<td>$203,875</td>
<td>$468,000</td>
</tr>
<tr>
<td>Southeast</td>
<td>$130,615</td>
<td>$226,706</td>
<td>$939,444</td>
</tr>
</tbody>
</table>

Among our respondents, not surprisingly, customization occurs at the high-end of the home spectrum. Nearly 70% of move-up, luxury, and retirement homes were custom built, compared to 52% of vacation homes and only 26% of starter homes.
Riding out the Boom

What is our plan for growth?

The housing market remains in the thick of an upturn that began more than a decade ago. Consumer demand – fueled by low interest rates, accessible credit, and minimal inflation – remains strong. The convergence of favorable economics and increasing financial wherewithal sets the stage for nearly every type of home builder to benefit from positive demographic and financial trends.

The demand for housing remains on an upward trajectory, with demographers estimating an average annual addition of 1.5 million households in the United States for the next 15 years.

- Baby Boomers, the demographic sector that has shaped the home-building market at each stage of their lives, are expected to create a significant increase in demand for housing in retirement and age-restricted communities. Younger Baby Boomers (in their 40s) are moving up to larger, pricier primary homes, and many are purchasing second or vacation homes as well.

- Children of Baby Boomers, or Echo Boomers, are just beginning to enter the housing market and are expected to drive demand even further.

- According to the U.S. Census Bureau, more than one million immigrants flock into the U.S. each year. In fact, immigration levels have been much higher than estimates projected by the National Association of Homebuilders. The unanticipated rise in immigration levels coupled with a trend for immigrants to purchase homes sooner upon relocation to the U.S. is continuing to fuel new home demand.

- In sum, Echo Boomers and immigrants are the two demographic segments expected to lead overall growth in the number of households over the next decade. Both groups are also likely to afford a secure market for older homeowners to sell their first homes and move up to higher-priced second and luxury homes.
Taking Acquisitive Action

As the industry consolidates, will we be acquiring or will we be acquired?

Consolidation is affecting the structure of the homebuilding industry. Homebuilders concerned about growth are finding the best way to expand successfully and meet a nearly insatiable consumer demand for new homes is to acquire other builders. Large homebuilders enjoy materials and labor cost advantages relative to small builders, in addition to superior access to capital. Recently announced deals include Lennar Corp.’s plans to acquire the Lamplight Homes division of Las Vegas-based Carina Corp. and Hovnanian Enterprises, Inc.’s acquisition of Oster Homes. Technical Olympic USA, Inc. also completed its acquisition of the homebuilding assets and operations of Transeastern Properties, Inc. According to Mergerstat, there were over two dozen acquisitions in 2004 and another 18 so far in 2005.

<table>
<thead>
<tr>
<th>Rank</th>
<th>Top U.S. Home Builders</th>
<th>2004 Revenue ($ mil)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Pulte Homes, Inc.</td>
<td>11,711.2</td>
</tr>
<tr>
<td>2</td>
<td>D.R. Horton Inc.</td>
<td>10,840.8</td>
</tr>
<tr>
<td>3</td>
<td>Lennar Corporation</td>
<td>10,504.9</td>
</tr>
<tr>
<td>4</td>
<td>Centex Corporation</td>
<td>10,363.4</td>
</tr>
<tr>
<td>5</td>
<td>KB Home</td>
<td>7,052.7</td>
</tr>
<tr>
<td>6</td>
<td>NVR, Inc.</td>
<td>4,327.7</td>
</tr>
<tr>
<td>7</td>
<td>Hovnanian Enterprises</td>
<td>4,160.4</td>
</tr>
<tr>
<td>8</td>
<td>M.D.C. Holdings, Inc.</td>
<td>4,009.1</td>
</tr>
<tr>
<td>9</td>
<td>The Ryland Group</td>
<td>3,951.8</td>
</tr>
<tr>
<td>10</td>
<td>Beazer Homes USA, Inc.</td>
<td>3,907.1</td>
</tr>
</tbody>
</table>

Source: OneSource

More than a dozen acquisitions during 2003 resulted in the top 10 builders increasing their total U.S. market share from 10% in 1995 to 20% in 2004.

The top 100 builders now control approximately 65 percent of the market. Some pundits estimate that the top 20 builders will account for 75% of new construction by 2011.
Keeping up With the Trends

What is the best way to keep abreast of what is happening in our industry?

Respondents rely primarily on trade literature to help them identify and react to developing trends in the housing market, with many respondents using trade publications intensively to keep current on industry news and trends.

Working directly with customers and responding to their needs and requests had the second highest number of positive responses from our builders.

Attending trade shows and conducting or using market research studies were identified as somewhat less desirable ways for respondents to keep current with industry news and trends. Ostensibly, these two methods represent the greatest cost in terms of both builders’ time and money.

Keeping Current

[Bar chart showing responses to different methods of keeping current]
When asked to identify the fastest growing practices in housing construction, respondents picked the burgeoning selection of interior amenities as the number one growth area.

**Comparison of Current Trends Growth**

Taking advantage of abundant selections of wood and tile flooring and higher-end kitchen materials selection were by far the most quickly developing practices.
Using Technology

How can we use technology to improve our efficiency and competitiveness in the marketplace?

Despite the cost of investment, technology is a key factor in achieving operational effectiveness. In fact, all respondents claimed to use technology to support some aspect of their business. The most popular applications include financial reporting software, and technology-based systems to support corporate purchasing and project management operations.

Use of Technology
General operational management systems are used by more than 50% of survey respondents. Most builders utilize systems to support financial operations as part of their firm’s infrastructure. Software applications that are typically considered “back office” functions – purchasing and project and operational management – are used to varying degrees by more than half of the respondents.

Other technical-support systems, such as sales management and lead tracking, are less commonly used by respondents. This may speak to the strength of the market and the ability of builders to readily sell their housing product, but recent research by J.D. Power & Associates, another unit of the McGraw-Hill Companies, found that home builders are realizing the benefits of repeat and referral business from satisfied customers.

With competition fierce among builders, large builders, especially, are turning to customer relationship management systems (CRM) to support marketing and business development efforts.

Use of Enterprise Resource Planning (ERP) systems is an area of great potential for the industry as a whole. Only eight of our respondents were currently using ERP systems. These respondents were all identified as large national builders. While the national players benefit from ERP systems that help them keep track of widespread operations and the distribution of large materials to many locations, smaller homebuilders, who often have grown from a sole proprietorship, may not yet have acquired the scope of operations or technical infrastructure to harness the advantages of an ERP system.

When it comes to measuring satisfaction with current technical systems, only 41% of the respondents agreed that their current systems were serving their immediate purposes “pretty well,” while another 31% said the systems served their long-term needs “fairly well.”
How can we take advantage of outsourcing services to reduce costs?

When asked about outsourcing technology services, both hardware and software are outsourced by about 30% of our respondents. In addition to technology, mortgage origination and sales support rank among the most popular avenues for outsourcing among respondents.

Use of Outsourcing Services

- Mortgage Origination
- Technology: Hardware Mgt.
- Technology: Software Mgt.
- Sales
- Marketing
- Warranty Work
- Other

*# Respondents*
Examining New Home Costs & Selling Value Chain

Key Components of Site Acquisition

- Identify attractive markets
- Buy or secure land
- Procure entitlements and permits
- Prepare land for homebuilding

For the on-site builder, the first step in the new building process is choosing an attractive geographic area and securing the land or lots (land which has been developed for building). At this stage, the builder must obtain environmental and other regulatory approvals. In the case of a builder constructing a planned community, approvals also have to be obtained for roads, drainage facilities, and sewers. Builders work closely with local government officials, and utility officials. The builder usually buys the land outright, but more builders are taking advantage of rolling lot option contracts which give them the right to buy land at specified prices on a flexible schedule. This allows them to pay a smaller amount up front.

With respect to the approval process, restrictive zoning and no-growth or slow-growth ordinances can reduce supplies of available lots for development in many metro markets, driving up land prices and the overall cost of homes. In some high-growth markets, the cost of a developed lot - raw land and improvements plus fees for basic infrastructure such as schools, roads, and sewer systems - now accounts for as much as 30% of the new-home price.
Both the availability of developable land and land-related delays in commencing development are viewed as the most significant barriers to production. Restrictive zoning practices and no-growth or slow-growth ordinances can diminish the supplies of available lots for development in many metro areas, driving up land prices as well as the overall cost of homes. In most high growth markets, the cost of a developed lot, which is defined as the raw land and improvements plus fees for basic infrastructure, such as schools, roads, and sewer systems, may reach as much as 30% of the overall home price.

**Perceived Impediments to Homebuilding Production**

Many municipalities and local governments also tack on “impact fees,” in addition to building permits, to cover the impact of additional population density on the local infrastructure. These extra fees are intended to compensate for street and road expansion and repair, linking new construction to utility, water, and sewer systems as well as providing for local schools, police and fire coverage and other municipal services.

Impact fees, which started nearly 30 years ago with the passage of Proposition 13 in California, have been growing over time and now the Chicago-based American Planning Association puts the national average for cumulative impact fees at $14,441 per dwelling unit. These fees can range from just a few hundred dollars in some areas to more than $100,000 in some parts of California. One study by the U.S. Department of Housing and Urban development estimated that additional fees have added to the cost of new homes by nearly 35% in some areas.
The Cost of Land

When land supply is an issue, how do we adjust our project development?

The cost of land as a percentage of the final home price is fairly consistent across different types of new homes. The land costs range from 24% to 28% among starter, move-up, and luxury homes. Not surprisingly, the regions with the highest cost of land, as a percentage of the final sale price, include the Northeast and the Midwest, as well as the states of Florida and California. In all four areas, the cost of land accounts for approximately 33% of the finished home cost.
New multifamily homes constructed by respondents demonstrated a similar land-to-total cost ratio. Starter multifamily properties averaged 24% of total cost to land. For “move-up” properties, land costs were 26% of total costs. For luxury properties, land accounted for 29% of the total finished home cost and land for custom-built luxury homes could reach as much as 50% of the cost of the finished home.

During a housing boom, builders typically pass costs associated with land constraints along to their buyers; however, there is concern that as interest rates rise, buyers will no longer be able to shoulder this burden. In surveying our respondents about the limitations on land supply, the majority suggest that building larger homes can compensate for a decrease in land availability. Building higher density one-family homes or using smaller lots were the two most popular alternatives to tight supply, followed by reuse or infill.
Raising Profits

Are we spending too much on land development?

The cost of land and land development costs top the list of factors that negatively impact profitability. The ease in purchasing land and the ability to control costs in the subsequent development of that land are critical factors in both the production of new homes and the homebuilder’s bottom line. It is interesting to note that while insurance costs ranked third in terms of their squeeze on profits, respondents viewed these costs as having less impact on actual homebuilding production.
Reducing Cycle Time

How do we reduce our building cycle time, budget variance, and defects?

The average build time for a single-family house was three to six months according to 64% of our respondents. About 22% of our respondents considered a time frame of six to 12 months as average for construction of a single-family residence.
Topping the list of important operational issues for homebuilders was the ability to acquire developable land at a reasonable price. Rising raw material costs ranked second in importance. The continued expansion of new home developments and significant events, such as the recent disaster in New Orleans which has created a surge in lumber prices, put additional pressure on homebuilders’ margins.

Building cycle time is affected by a host of factors, especially the efficiency of permitting processes, timely availability of materials and supply of qualified employees. In an effort to prevent increases in build cycle time, some builders opt to create speculative inventories. This type of inventory is used to lure would-be buyers who do not want to wait for a home to be built.

“Spec” homes are available for immediate purchase and are ready for buyers to move in quickly. The downside of the speculative inventory approach is an inventory glut if the local market cools. Risk-averse builders typically suspend any construction on a new home until a purchase contract, notice of mortgage approval, or customer deposit is in place.

Another approach to alleviating operational pressure is to develop an inventory of land for future use. Almost half of the surveyed respondents retain an inventory of three or more years of developable land. Another 27% of builders carry a two-year lot inventory that can be tapped for future development.
Home Design

Designing the Home

Do we need to look elsewhere for home design ideas?

Of paramount importance in the new home-building value chain is meeting home buyer needs. This means creating homes with features that are in keeping with the tastes and income levels of the region. A home that is out-of-step with the surrounding demographics is at risk of not being sold.

If a builder is confident in its ability to gauge the needs of the local market, it may choose to work its own designs. A builder who is expanding into a new area, however, is more likely to hire local architects, interior designers, and consultants to make sure the local orientation is captured.

Our builders indicate on average that more than 70% of their house designs are supplied by either in-house or external architects, or an architectural firm under contract.

Homebuilding Designs by Source
Purchase Materials

Buying the Materials

Where is our supply chain can we find additional savings?

 Builders are typically responsible for purchasing materials for new home construction, even if subcontractors are used to perform the actual work. Major raw materials include drywall, concrete, and lumber. Other essential materials such as windows, heating and cooling systems, and fixtures, are also customarily purchased by the builder. Nearly all large builders procure materials through a centralized purchasing department.

The advantage of this method is the ability to purchase quantities in bulk, thereby commanding lower prices and better deals from suppliers. Large homebuilders are still in the early stages of capturing their full advantages in procurement.

About half of our surveyed builders maintain corporate-wide contracts with specific building product manufacturers for such items as appliances, cabinets, roofing, flooring and framing. Respondents were more likely to contract for intermediate finished goods like appliances and plumbing fixtures. Raw building products, such as siding and lumber, were secured under contract by less then 50% of the respondents. HVAC systems are the only intermediate finished system that is contracted by less then 50% of respondents.

Percentage of Respondents Who Purchase Direct From Manufacturer

<table>
<thead>
<tr>
<th>Material</th>
<th>Percentage of Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lumber</td>
<td>30%</td>
</tr>
<tr>
<td>HVAC</td>
<td>40%</td>
</tr>
<tr>
<td>Siding</td>
<td>30%</td>
</tr>
<tr>
<td>Roofing</td>
<td>30%</td>
</tr>
<tr>
<td>Flooring</td>
<td>30%</td>
</tr>
<tr>
<td>Plumbing Fixtures</td>
<td>40%</td>
</tr>
<tr>
<td>Windows</td>
<td>50%</td>
</tr>
<tr>
<td>Cabinets</td>
<td>60%</td>
</tr>
<tr>
<td>Appliances</td>
<td>70%</td>
</tr>
</tbody>
</table>
Accounting & Financing

Accounting for It

Are we prepared for the affect of gaap reporting under FIN 46?

**GAAP FIN 46**

Regulatory changes now require builders to consider the implications of FIN 46(R), when evaluating joint ventures and land banking arrangements. Builders must determine if the entity or arrangement would be required to be consolidated - or “put on the books” along with the related debt. Previously, joint ventures were evaluated under a different set of rules and there were no specific requirements covering land banking arrangements, although certain non-specific rules applied.

FIN 46 requires a builder to first determine whether a joint venture or land banking arrangement is considered a variable interest entity (VIE). Joint ventures may or may not be so, depending on the structure and underlying business. Land banking arrangements are almost always considered a VIE, due to the inherent structure, although some ultimately get scoped out. Once a builder determines that a joint venture or land banking arrangement is a VIE, it must determine who is the primary beneficiary.

This process can get quite complicated and often involves the builder developing a specific model to make the determination. If the builder is the primary beneficiary, then consolidation is necessary.

Public companies were required to adopt FIN 46 in 2004. Private companies had to adopt for new or modified arrangements in 2004 and for existing arrangements in 2005. Private companies seem less concerned about the impact from consolidation since their financial results are not being analyzed in the public domain.

When asked whether recent changes relating to GAAP reporting under FIN 46(R) would affect builders’ use of subsidiary entities to purchase land for development, the majority of respondents believed the new requirement would not induce them to change their processes at all.

About 25% of respondents said they would buy more land directly. When it came to the continuing use of joint ventures, renegotiating new agreements, as well as the use of land banks, more than 40% of respondents said they were “not at all likely” to make a change based on the new regulations.

These numbers were enhanced in each category by an additional 20%-25% who said these changes were simply “not likely.”

A solid group took the middle ground on these issues. Between 20%-30% of respondents said they “may” make some changes along these lines. Respondents who were “somewhat” or “very likely” to make a change were in the single digit percent range, meaning less than 10% of respondents in any category were likely to do anything in response to these regulatory changes.

**Warranty Expense**

The computation of warranty expenses is another area of accounting concern. Our respondents were generally split in how they compute expenses, with 42% suggesting that they charge a percent of the price or cost, while another 43% charge a fixed cost per home sold.
Sales & Marketing

Marketing and Selling the Home

Which marketing approaches will drive the most sales?

Marketing Approaches

This phase of the value chain is different for builders who create a speculative inventory rather than wait until they have a commitment from the buyer. The two major methods that builders use to sell residences include employing an in-house sales force and using independent real estate brokers. Other popular marketing tactics include advertising in newspapers and magazines, on billboards, and via direct mail.

Customer referrals or detailed builder websites are other ways to find prospective buyers. On average, respondents indicated that their marketing and advertising costs were less than three percent of sales revenue.

Showcasing a builder’s wares through development of model homes represents another popular way to sell new homes. Targeted to fit the tastes of the local market, model homes are ideal for would-be buyers who are concerned about getting as much information – as well as a first-hand look and feel – about the builder’s product before making an investment. Some model homes display extra features, such as master bedroom fireplaces and high-end cabinets, which consumers can select for an additional cost.
Associated with this aspect of the builder’s business management cycle are selling, general, and administrative costs. Most of our respondents were able to keep SG&A costs between 6%–10% of total sales.
Dealing With Cancellations

Reasons for Buyer Cancellations

Once a prospective buyer has placed an order on a house, the builder often helps the buyer obtain a mortgage. Being able to offer competitive financing to the buyer is often a key factor in making a sale, and as a result many large builders now operate their own mortgage banking units.

Builders who do not have their own financial services units also commonly assist buyers in obtaining financing. Many builders also provide closing services for their customers, as well as title insurance.

Once their loan approvals are received, more than 95% of buyers complete the purchase of their newly constructed home. Despite favorable interest rates and a plethora of financing options, cancellations are still an eventuality for some transactions. Top reasons usually involve issues with a home buyer’s financial situation.
Despite mounting interest in designing, building, and occupying more environmentally sensitive homes, only nine percent of our respondents considered “green features” to be very important to home buyers. In fact, almost half our respondents viewed green features as not important to potential home buyers.

However, the top environmentally friendly features offered by respondents included insulation and window glazing options. Recycled materials and roof options were offered by the fewest number of respondents.

How do we respond to customer desires relating to home customization and the environment?
Conclusion

Taking in the Big Picture
When Growth is Good, Return on Invested Capital is Superior

In the final analysis, the goal of any homebuilder – large or small – is to create economic value. Commanding prices that are greater than the full costs of producing homes is only part of the value equation; the other part is achieving superiority in long-term return on investment.

Despite a positive outlook for new housing demand and favorable capital market discipline, our survey underscores fundamental shifts that are harbingers of future industry change:

Land is increasingly scarce in desirable markets.

Land use regulation is limiting the amount of developable land in many major markets and creating an increasingly capital intensive, complex, and lengthy process for entitlement, in addition to driving up the cost of land.

Local is still important in terms of scale but regional and national procurement is growing.

Materials procurement is becoming more regional and national, not just local, which means that large homebuilders are reaping strong advantages in procurement. This is a trend that is mounting in scope and effect across the industry.

As large builders gain economic advantages in procuring materials, accessing capital and attaining developable land, their profitability and prominence will continue to expand at the expense of small builders.

Consolidation is a sure bet.

The homebuilding industry is in the throes of consolidation. Large builders will continue to increase market share by acquiring local and regional builders. The merging of large mid-level builders could further alter the landscape and bring new behemoths into the game. In the end, without an easing of new home appeal, home builders have little choice but to grow in order to meet demand.

Contact

Deloitte & Touche LLP
Paul Prescott
National Tax Managing Principal, Homebuilding
Deloitte Tax LLP
(714) 436-7148
pprescott@deloitte.com

Pete Culliney
Real Estate Research
Deloitte Services LP
(212) 436-5039
pculliney@deloitte.com

McGraw-Hill Construction
Burleigh Morton
Senior Director
McGraw-Hill Construction
Research and Analytics
(781) 860-6842
burleigh_morton@mcgraw-hill.com

Anita Gryan
Director of Operations
McGraw-Hill Construction
Research and Analytics
(781) 860-6434
anita_gryan@mcgraw-hill.com
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