

Builders chase millennials by moving down price scale

Buyers building equity at the expense of future needs

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Surging prices have almost closed off the new-home market to young buyers like Brandon and Quincey Lindemann. But the Denver-area couple has found a way in.

The Lindemanns paid \$350,000 in October for a three-bedroom house at Tri Pointe Group Inc.'s Terrain, a new Castle Rock, Colorado, community designed for first-time buyers. While the home has press-board kitchen counters and a yard too small for the children the Lindemanns plan to have, it's almost 30 percent cheaper than the average for a new house in the area.

"We were willing to sacrifice some luxury to have some solid equity in a home," said Brandon Lindemann, 25, an auto-repair shop manager who plans to install tile flooring himself. "We couldn't afford much more than the basic, but I'm a pretty big do-it-myself person."

Following the success this year of D.R. Horton Inc.'s low-cost Express brand, national firms including Tri Pointe, Taylor Morrison Home Corp. and Meritage Homes Corp. are testing cheaper offerings in markets from Colorado to Florida to California. Builders had shifted away from entry-level buyers following the housing crash and instead focused on developing larger, more-profitable homes during the recovery that began in 2012 amid an increase in land and labor costs.

"The recovery in the move-up segment is getting long in the tooth — there are only so many buyers who can pay \$400,000 and above," said Drew Reading, a homebuilding analyst for Bloomberg Intelligence. "The main concern in 2016 and beyond is that affordability is becoming a bigger issue."

The push to build bigger may be slowing. The median size of a new single-family home was 2,445 square feet (227 square meters) in the third quarter, little changed from a year earlier, after rising 17 percent over six years from a low in 2008, according to an analysis of U.S. Census Bureau data by Robert Dietz, an economist with the National Association of Home Builders.

D.R. Horton, the nation's largest builder, now collects 14 percent of its revenue from its Express brand, which it started last year and plans to expand in 2016 to most of its 79 markets. LGI Homes Inc., a Texas-based builder of entry-level houses that became a public company two years ago, has been the best-performing homebuilder stock this year. It reported an 88 percent increase in revenue in the third quarter from a year

earlier.

"When D.R. Horton first announced that it was going to go after the entry level portion of the market, a lot of other builders wanted to wait and see how it turned out," Brad Hunter, chief economist for housing-research firm Metrostudy, said in a phone interview. "Now that they've seen the concept proven, they're figuring out their own way to provide a home that's more affordable."

New homes in the U.S. sold at a slower pace than projected in November. Sales rose 4.3 percent to a 490,000 annualized pace following a 470,000 rate in October, according to the Commerce Department. The median estimate of economists surveyed by Bloomberg called for a 505,000 pace, and purchases in the prior three months were revised lower.

Most builders continue to chase larger profit margins by catering to move-up and luxury buyers. Large builders such as Lennar Corp. and PulteGroup Inc. continue to focus on wealthier customers rather than first-time homeowners.

"Most builders say land prices are so expensive it doesn't pencil out," said Alex Barron, an analyst with Housing Research Center in El Paso, Texas.

While PulteGroup isn't pushing into the entry-level market, it is going after affluent millennials by building homes in close-in suburbs near Boston, San Francisco, Atlanta and Washington, said Mary Rachide, the company's vice president of strategy. One condominium project near a subway station in Fairfax, Virginia, for instance, has a starting price of \$539,990.

Tri Pointe, which built the Lindemanns' home, plans to increase its share of first-time buyer properties to 40 percent from about 35 percent now, according to Chief Operating Officer Tom Mitchell. The homebuilder expanded its offerings in Denver, Las Vegas and Phoenix, in addition to its entry-level communities in California regions including the Inland Empire and Contra Costa County.

"It's good to see demand back in the marketplace — it gets builders to be creative and come up with ways to meet that demand," Mitchell said in a phone interview. "When we can find the land and create the product to deliver affordable price points, they are selling."

Few builders target the lowest price ranges because communities with those types of homes would be most vulnerable should there be a downturn. Meritage has been expanding a segment it calls "entry-level-plus," which starts in the low

\$200,000s in the Houston area. D.R. Horton's Express brand and LGI have an average price of about \$190,000 across their U.S. markets.

Low mortgage rates, which have allowed buyers to buy more costly properties, may soon start to increase following the Federal Reserve's decision this month to raise interest rates for the first time in almost a decade.

As the job market improves, competition is heating up for the tight supply of homes. The S&P/Case-Shiller index of existing-home values in 20 U.S. cities rose 5.5 percent in October from a year earlier, the group said Tuesday.

"Home-price appreciation

has gotten to the point where if interest rates start moving up significantly, there's going to be greater demand for the lower price point," said Brent Anderson, a Meritage spokesman.

All eight communities that Meritage plans to open next year in the Houston area will be in the entry-level-plus category, partly because lower oil prices have already cut into sales in the higher-priced segments, said Steve Harding, president of the division. Last year, 60 percent of projects in the region were for move-up buyers.

The entry-level-plus homes are \$50,000 to \$100,000 cheaper than the company's typical homes in the Houston market because they're smaller. Designers removed fireplaces and the standard mud room off the garage and put masonry only on the front of a home, Harding said. The cost of land for one community was lower because it's on the less-convenient side of a bridge, he said.

In Denver, one of the nation's fastest-growing markets, buyers are running out of options. The Lindemanns said they considered buying an existing home, but were scared off by stories of bidding wars with dozens of offers.

"We were tired of paying rent," Brandon Lindemann said. "When we have kids, we can get the dream house with a big backyard, at a time when we're making a lot more money."