

Preparing for the Up-Swing

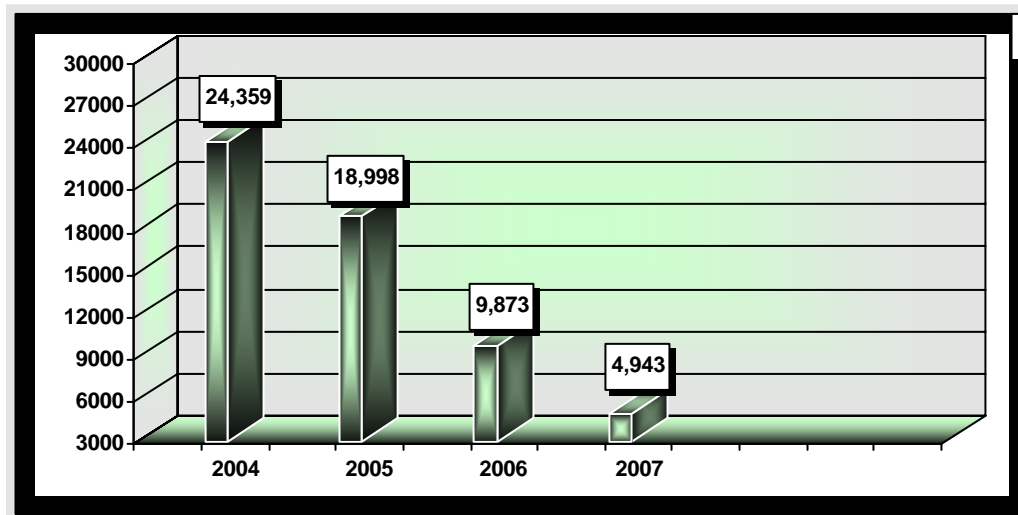
(It IS Coming!)

Indicators, Triggers, and Strategies

Presented By:

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- I. Many builders have not experienced a housing recession
 - a. Were not in business during the last housing recession
 - b. Very few builders have experienced a severe housing downturn
 - c. Going to be longer and deeper than any housing cycle we have experienced in the last 60 years
 - d. 2008 will probably be worse than 2007 for many builders
 - i. Excess inventories of existing and new homes
 - ii. Cancellations
 - iii. Declining home prices
 - iv. Land values will continue to fall
 - v. Foreclosures will increase
 - vi. Tightening bank credit for A&D,& Construction loans
 - 1. Creating REO departments



DETROIT ANNUAL HOUSING STARTS -- EXCLUDING RENTALS

- II. Many builders will not survive this recession
 - a. About 15% of the builders did not survive last year
 - i. 2008 will see substantially more failures
 - b. Many builders are lost in how to react to the housing recession
 - i. They do not have implicit knowledge (“mental map”) of a housing recession
 - 1. Many are in denial
 - 2. Others are in fear and panic
 - ii. They are disoriented
 - 1. Erodes their ability to perceive the issues
 - 2. The mind cannot solve the problems
 - iii. They become frozen
 - 1. Continually do more of the same thing expecting different results
 - a. Definition of insanity according to Albert Einstein
 - 2. Just work harder and harder
 - c. Operating in a disoriented state
 - i. Still operating on an old business model
 - 1. Not gotten rid of spec inventory
 - 2. Done nothing with land inventory
 - 3. Held on to staff too long
 - 4. Diluted cash reserves
 - 5. Still have high leverage
 - 6. Hidden from banks and creditors
 - ii. The eternal optimist
 - 1. The housing recession is over
 - 2. It is only a seasonal downturn
 - 3. My market is different and isolated
 - 4. It’s only going to impact the big builders
 - iii. These builders are in denial
 - 1. Do nothing different
 - 2. Hope the problem will go away
 - 3. It is all a dream!
 - d. Operating in a panicked state
 - i. Full scale survival urgency
 - ii. Clear thought is impossible
 - iii. Actions are frantic
 - iv. Becomes unproductive
 - e. Both groups have a high chance of failure during this cycle
- III. The five stages of being lost – No knowledge (mental map) about where you are
 - a. Deny you are disoriented
 - i. Press on with growing urgency
 - b. Urgency becomes full scale survival emergency
 - i. Clear thought becomes impossible
 - ii. Action becomes frantic
 - iii. Unproductive
 - iv. Energy deteriorates

- c. Form a strategy to find something that matches your knowledge or mental map
 - i. Try to match situation to your past experience
 - ii. Strategies do not produce expected results
- d. Deteriorate both emotionally and rationally as strategies fail
 - i. Frustration increase
 - ii. Energy levels decrease
- e. Run out of options and energy
 - i. Become resigned to plight

IV. Steps for Survival

- a. Final stage of being lost is either the end or the beginning
 - i. Some people just give up
 - ii. Some people stop denying and start surviving
- b. Critical moment when you become convinced you will survive
 - i. The faster you reach this point the better your chances of survival
 - ii. Move through denial, anger, bargaining, depression, and acceptance vary rapidly
- c. Positive mental attitude is a must (The Right Stuff)
 - i. Turn fear into focus
 - ii. Believe anything is possible
- d. Make a new mental map of your situation
 - i. Develop a survival plan that is flexible
 - ii. Stay calm
 - iii. Accept reality of the situation
 - iv. See opportunities in the situation
 - v. Organize quickly
 - vi. Set small goal
 - vii. Celebrate wins
 - viii. Be willing to take risk
 - ix. Do whatever is necessary to survive
 - x. Nothing will frustrate you

V. Actions for survival

- a. Get your financial house in order
 - i. Horde cash
 - 1. Cash is KING
 - 2. Cash flow and liquidity before profits
 - 3. Sunk cost is gone!
- b. Don't hide from your banker
 - i. Communicate, Communicate, Communicate
 - ii. Put a business plan together
 - iii. Renegotiate your loans before they get into trouble
 - 1. Banks don't want your land or homes
 - iv. Cooperative vs. uncooperative customers
 - v. Once the loan is in default the bank can't do much

- c. Diversify your financial institutions
 - i. Don't put all your eggs in one basket
 - 1. Be careful with sweep accounts
 - ii. Banks have different lending practices
 - 1. Rebalancing their portfolios
 - 2. More financial statement lending
 - iii. Banks can get into trouble too
 - 1. Liquidity
 - 2. Reserve requirements
 - iv. National vs. local banks
 - 1. Where are the decisions made
- d. Get rid of your spec home inventory
 - i. They are a drag on your company
 - ii. Turn them into cash
 - iii. Get out of debt
- e. Get rid of your land (if possible)
 - i. Holding costs will kill you
 - ii. Walk away from options
 - iii. Renegotiate take downs and terms
 - iv. Put together an investment group for land banking
 - 1. There will be a lot of opportunities when the market turns
- f. Work on your direct construction costs
 - i. Downgrade your specs
 - 1. 2002/2003 specification levels
 - 2. Drop ceiling heights
 - 3. Different spec levels for 1st and 2nd floors
 - ii. Value engineer
 - 1. Question everything
 - iii. Work with trade partners
 - 1. They know where your waste is
- g. Target market your product
 - i. Survey your customers
 - ii. Design product and processes to fit customer
 - iii. Make every system and process customer friendly
 - iv. Niche market
 - 1. Smaller market
 - 2. Less competition
 - v. Smaller more efficient product
 - vi. Move closer to city center
- h. Trim your overhead
 - i. Need to maintain balance with volume
 - ii. Opportunity to improve quality of staff
 - iii. Become more efficient and effective

- i. Improve your systems and procedures
 - i. Flowchart and standardize
 - ii. Totally implement computer system
 - iii. Streamline processes
- VI. Do you have the “Right Stuff” to survive
- a. Do you have a survival plan?
 - i. Is it flexible?
 - b. Will you cut overhead deeper than you think?
 - i. Means staff layoffs
 - ii. One of the hardest decisions
 - c. Will you mothball communities?
 - i. Doesn't have adequate sales
 - ii. Wrong location
 - iii. Wrong product
 - d. Will you discount your house spec inventory?
 - i. Breakeven or below
 - ii. Built in a different economic climate
 - iii. Sunk costs
 - iv. Liquidate as quick as possible
 - e. Will you walk away from earnest money deposits on land?
 - i. Don't throw good money after bad
 - f. Will you dispose of your land inventory?
 - i. How low will you go? – at any cost
 - ii. Debt service on land has cause more builders to go bankrupt than anything else
 - g. Will you change your product to be more customer focused?
 - i. Improve customer research
 - ii. Cater to a smaller target market
 - h. Will you reduce the standard specifications in your home?
 - i. Need to do this three times before you are close to where you need to be
 - i. Will you work with your trades as partners?
 - i. They know where you are inefficient
 - ii. They are part of your team
 - iii. Help them survive too
 - j. Will you liquidate your building company?
 - i. A number of builders have done so
 - ii. Protected assets from deterioration
- VII. Builders typically miss the cycle turns
- a. Historically miss cycle turns
 - i. Six months to a year behind
 - b. Bottom of cycle will feel terrible
 - i. Confidence very low
 - ii. Banks won't loan
 - iii. No one wants real estate
 - iv. Foreclosures and bankruptcies

- c. Need to establish leading predictor trend charts
 - i. Forecast cycle turns
 - d. Recovery will be slow
 - i. Scrap along the bottom for awhile
 - ii. Window of opportunity will be longer
- VIII. Preparing for the recovery
- a. Plan for the recovery now
 - i. Develop plans and strategies now
 - 1. Tie to leading predictors
 - b. Establish most probable business plan
 - i. Bracket plan
 - 1. More optimistic plan for recovery
 - 2. More pessimistic plan for recession
 - ii. Tie to leading predictors
 - c. Opportunity will be greatest at the bottom of the cycle
- IX. Leading predictors to chart
- a. Chart three sets of leading predictors (monthly)
 - i. General local housing market
 - ii. Existing home market
 - iii. Internal company information
 - b. General local housing market predictors
 - i. Mortgage interest rates
 - ii. Housing foreclosures
 - iii. Net employment change
 - iv. Building permits
 - v. Retail sales tax revenue
 - vi. New automobile sales
 - c. Existing home market predictors
 - i. Number of homes listed
 - ii. Average days on the market
 - iii. Average existing home sales price
 - iv. Sold price to asking price ratio
 - d. Internal predictors
 - i. Weekly buyer traffic units
 - ii. Traffic capture rate (contracts/traffic units)
 - iii. Percentage of contingent contracts
 - iv. Contract fall out rate
 - v. Voluntary cancellation rate
- X. Triggers for action
- a. Ask a series of “What if. . . ?” questions for each predictor
 - b. Develop strategies to implement

- c. Establish trigger points for implementation of strategies
 - i. Tie strategies to trigger points
 - ii. Automatic implementation

- XI. Window of opportunity
 - a. The better the plan for the turn in the cycle the bigger the window of opportunity
 - b. Most will still believe market is continuing to deteriorate
 - c. Will probably not recognize turn for 6 to 9 months

- XII. Recovery plan and Strategies
 - a. Implement as soon as bottom is apparent
 - b. Isn't going to feel good
 - c. Opportunities best when everyone else is pessimistic
 - d. Be in position to take advantage
 - e. Once in a lifetime opportunity

- XIII. Strategies for the recovery
 - a. What is the minimum cash balance you want to maintain
 - i. Operating line of credit management
 - ii. Equity investors for recovery
 - b. How are you going to increase your market share
 - i. Filling the void of builder departures
 - c. How are you going to compete
 - i. Price
 - ii. Quality
 - iii. Service
 - d. Who are you going to target
 - i. Builder's market share
 - ii. Customer segment
 - e. How are you going to serve the customer
 - i. How do you create urgency
 - ii. How do you make it easy to buy
 - f. What is your pricing strategy
 - i. How and when do you increase prices
 - ii. What sales velocity do you need
 - g. When do you begin to re-staff
 - i. Who and when
 - ii. Ratchet up quality of staff
 - h. Land strategy
 - i. How much
 - ii. Where
 - iii. What stage of development
 - i. Debt strategies
 - i. Maximum debt to equity ratio

XIV. Recovery Opportunities

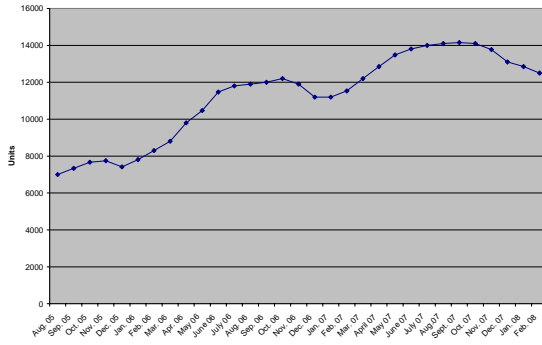
- a. There will be a lot of opportunities created by this housing recession
 - i. Be proactive with plans of action and strategies
 - ii. Tie to leading indicators
 - iii. Most builders will miss the bottom
 - 1. Will not react until too late
 - iv. It won't feel good at the bottom
- b. Weeds out some of the bad competition
 - i. Nationals will contract
 - ii. Many builder will go out of business
 - iii. Creates a void in market
 - iv. People still buying homes
 - v. Develop a strategy to expand market share
 - 1. Target builders leaving
 - 2. Fill the void
- c. Time to improve your systems and staff
 - i. Fully implement and upgrade computer systems
 - ii. Streamline and standardize processes
 - iii. Ratchet up quality of staff
 - 1. There are a lot of good people on the market
- d. Bank workouts
 - i. Maintain a good relationship
 - ii. Get to know bank REO managers
 - iii. Can help weather the storm
 - iv. Can be great cash flow generators
 - v. Be aggressive
 - 1. They need someone to manage the real estate
- e. Land acquisition
 - i. Availability – first
 - ii. Terms and conditions – second
 - iii. Pricing – finally
 - 1. Worth almost nothing at the bottom of cycle
- f. Foreclosures
 - i. These come toward end of cycle
 - ii. Land opportunities
 - 1. 10 to 30 cents on the dollar
 - 2. Very favorable terms
 - iii. Banks have written it off

XV. Summary

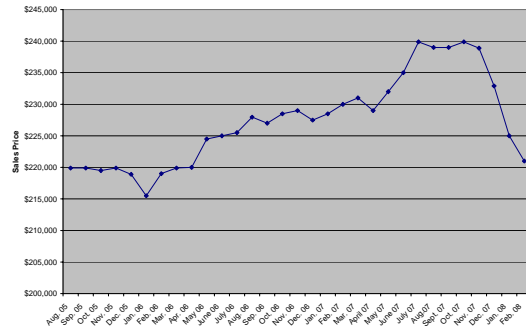
The housing recession will create once in a lifetime opportunities. You need to be able to survive the recession and be in a position to take advantage of the opportunities at the bottom of the cycle to maximize your benefits as the industry recovers. Builders that weather the storm and maintain their cash and borrowing ability can be in a stronger position at the end of the recession than they were going into the recession.

GOOD LUCK!

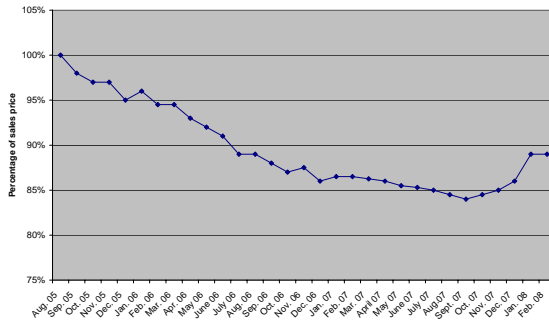
Total Existing Housing Inventory



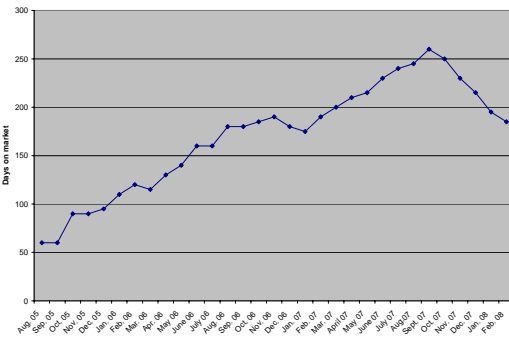
Existing Homes Median Sales Price



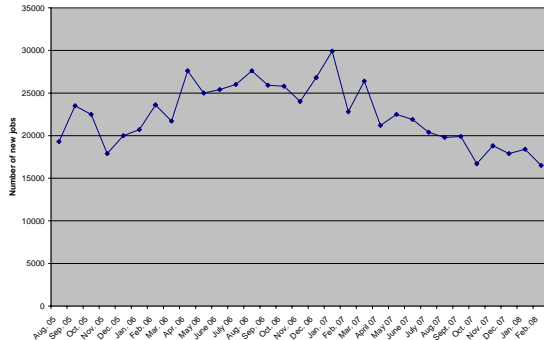
Asking Price to Sold Price Existing Homes



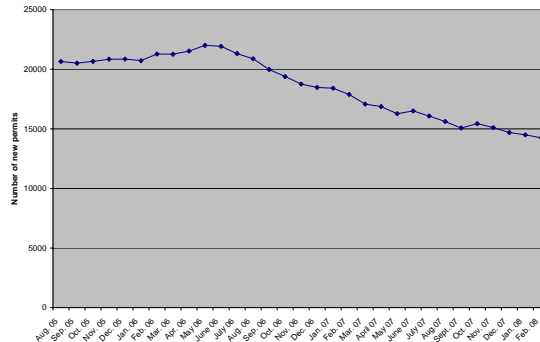
Average Time on Market



Change in Employment



Building Permits



Change in Employment / Building Permits E/P Ratio

