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Developers study market demand, plan carefully

By LYNETTE HAALAND

Housing developers take on myriad challenges—purchasing land, targeting a market, getting approval—usually only for single-digit profit margins.

"Considering the risks that a builder/developer takes, there's not that huge of a profit margin," says Rick Herman, executive vice president of Rochester Home Builders' Association.

In a builder's business model, acquiring land is just the first step. Being visionary about market demand, creating a master plan, getting it through the lengthy and uncertain approval process, and having the capital to install utilities and roads are others. It usually takes months and years before it is time to build houses and recoup expenses.

"A lot of cash goes out before cash starts coming in," says Peter Vars, vice president with BME Associates, a land planning firm.

Small-volume developers and builders nationwide average a 4.6 percent return on the bottom line, the net profit before taxes, according to the National Association of Home Builders' 2006 "Cost of Doing Business" study. Including the land around the house, the average profit is 5.8 percent.

In Rochester, profits generally range from 2 percent to 9 percent a house, depending on the type and price of homes built, RHBA's Herman says.

For instance, Pittsford-based custom builder Ketmar Development Corp.'s pretax profit goal is 6 percent, says Marie Kenton, president.

Ketmar is in various stages of two developments. Its Malvern Hills development in Pittsford has 14 of its 35 lots left and could take five more years to complete. Seneca Point Landing, another Ketmar project, is a 47-acre, proposed 20-lot development on the west side of Canandaigua Lake in South Bristol. The parcel currently is undergoing the state environmental quality review and plans are in place to start infrastructure work in the fall. Ketmar purchased the property a year ago.

Buying property for a housing development project is a huge expense for developers. Area builders usually pay $5,000 to $20,000 an acre for residentially zoned land, BME's Vars says.

Photo by Kimberly McKinzie

The number of steps and costs involved to bring a development to market have risen dramatically in the past 18 years that Marie Kenton, president of Ketmar Development, has been building homes.

Land in east-side towns—mainly Pittsford, Penfield, Perinton and Victor—fetches a higher price as compared with land in west-side towns and in other areas, including Wayne and Ontario counties, Vars says.

Town zoning also makes a difference in price. In Pittsford, for example, land is limited and the town has a certain "green" print, or amount of undeveloped land it wants to keep, Vars says.

Once the property is purchased, it can take developers anywhere from 12 to 24 months to break ground on construction, contingent on the review and approval process.

"Developers and builders have to go through such an arduous review and approval process before they can realize a return," Vars says.

It took Webster-based Crosstown Construction Inc.'s 11-lot patio home development, Bentley Park, in Perinton two years and nearly $200,000 in the approval process, including architecture, traffic flow and environmental studies, to start work. A road currently is being paved.

The approval process has pushed the cost of land higher, especially over the last decade, says Garry Britton, sales manager at Crosstown and associate broker with Re/Max First.

Ketmar's Kenton agrees. She says the number of steps and costs involved to bring a development to market have increased dramatically in the 18 years that she has been building homes.

An environmental study at Ketmar's Malvern Hills site, for example, discovered prehistoric campfires. They were exhumed at the cost of $30,000 and two weeks' delay. The developer often pays for all of the studies, plans and municipal reviews.

"The amount on top of the cash register goes higher and higher the longer and longer (the approval process) takes," RHBA's Herman says.

In total, BME's Vars says, including land cost, site development, municipal review, permit fees, engineering and legal fees, the hard costs per single-family home lot range from $40,000 to $60,000 in the local market.

Some builders make a 100 percent return on the lot. Others waive the lot cost and make money on building the house. Ketmar generally earns between a 20 percent and 50 percent profit on its lots, which Kenton thinks is average in the Rochester market.

Following the approval, site development and lot sale, it can take another three months to build a house.

"It all takes time, years of investing money before we can even fill a house," Crosstown's Britton says.

Most developments have a model home, which tries to set the standard for the community and attract buyers.

Crosstown builds model homes and staffs them with a hostess. It also builds spec homes in anticipation of buyers, which helps attract prospective customers. Since January, Crosstown has sold 18 homes in its five subdivisions, Britton says.

But not all developers achieve success. When a venture does not go as planned, builders are forced to wait or change their strategy. Some have to reduce profit margins to sell homes, while others lower prices of homes or increase density—add more homes to the development than originally planned—to attract a different market. Builders also bring in other developers to help finish a project. And some go out of business, Herman says.

In the 1980s and early 1990s developers were buying large parcels of land in Pittsford, Penfield and Perinton but found the local market had shifted and demand dropped off for what they offered. When projects stalled, developers were not only land-heavy but also were paying taxes on property they had already spent money on for improvements with infrastructure, Herman says.

Today local developers are more cautious. Many work with smaller parcels so they can change course more quickly with market demand. Developing 50 acres in a five-year window is more common now than trying to develop 400 acres in a 10-year window like in the past, Herman says. Currently 40 different communities are being developed here, where some 1,350 homes were built last year.

Crosstown has three new developments in the works. Its strategy is to work with pocket developments, or those with 20 lots or less, so it can react to market demands easier, Britton says.

"In our case," Kenton says, "we're building at a price point where we have to be patient."

Home prices at Malvern Hills and Seneca Point Landing are in the $1 million range, which includes large wooded lots.

"Some (builders) prefer to finish faster," Kenton says. "That's not our thing. We're trying to create a little legacy here."

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