

From Big Builder 2010
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Texas Builder Finds Private Equity Partner **LGI Homes forms land-buying joint venture with GoldenTree InSite.**

By Teresa Burney

On almost all counts, LGI Homes is an exception to the housing recession.

While other privately funded builders across the country died, hibernated, or treaded water, this Texas-based builder continued to sell everything it could build at a profit. So successful was LGI that it made plans to grow, with the goal of more than doubling itself from 433 homes a year to more than 1,000.

That's when LGI ran into the same problem every other privately funded builder faces: Finding capital.

"We were financed by our existing banks--and they were happy with us--but they didn't want to take on any new risk," said LGI CEO Eric Lipar. So the company asked other banks for financing, thinking it shouldn't be a problem since the builder had been profitable.

So much for that. "Other banks didn't want to take on any new risk," Lipar said.

Then the builder heard that RBC Bank, which finances its construction, was pulling out of the Texas market. Facing all that, it looked like growth was no longer an option. "Our internal plan was probably to slow down construction and start building with a lot of cash," Lipar said.

Then the private builder met private equity via an introduction from Tony Avila of Avila Advisors. GoldenTree InSite Partners, a private equity company, had been sitting on the sidelines for two years waiting for the right moment to jump into the residential land market in the United States. Other than investing in a land buying project with K. Hovnanian Homes in October, GoldenTree had held tight to the \$500 million it planned to invest.

"LGI, they are tremendous," said GoldenTree president Tom Shapiro. "They're the only profitable builder over the last few years that has actually increased their sales in the downturn."

GoldenTree and LGI formed a joint-venture partnership and recently closed on their first investment together, the purchase of 175 finished lots in the Chisholm Springs subdivision in [Fort Worth](#), Texas. LGI invested 15% of the purchase price, while a fund managed by GoldenTree anted up the rest. The builder will manage the day-to-day operations. If financial targets are met, LGI will receive a share of the cash returns. If GoldenTree invests a large amount in LGI in the future, it will have the option to buy a share of the company.

Other land deals with LGI are in the works.

“We are hoping to go out and buy eight to 10 deals in the next 12 to 18 months in Texas,” said Lipar. The plan is for LGI to be building 1,000 houses a year by 2011 or 2012.

Bank financing would have been a preferable way to grow, said Lipar. It’s less expensive than the private equity route, he added, but since bank financing isn’t a possibility now, the issue is really moot. “It was either close with GoldenTree or not close at all,” he said.

But Lipar is happy with the GoldenTree partnership. “We think it was a very fair deal,” he said. The builder’s existing four projects are separate from the arrangement that LGI struck with GoldenTree, and there are no personal guarantees in the deal.

Besides, the deals LGI and GoldenTree are making are at such low prices that there is plenty of profit to share. The lots they are buying cost between 30% and 50% of what it would cost just to build the infrastructure alone for the lots, making the land essentially free. “You are buying the deal so cheap that you are still better off” despite the higher financing costs, Lipar said. “It cost me roughly \$25,000 to put a lot in the ground, and these lots we are buying are 30% to 50% below that.”

Those kinds of deals on finished lots won’t last forever. “It’s a short window,” he said.

Shapiro agreed, adding that prices are so low now that “you don’t have to write in any appreciation at all” for the numbers to work. GoldenTree’s next target is to purchase land that is located close-in to metro areas, has entitlements, and still needs infrastructure. “We are trying to stay one step ahead of the [public] home builders” who are buying finished lots now and will need more in the future, he said.

GoldenTree is working on deals with other builders as well, including one due to close next week for “tens” of thousands of lots. “We were shut off in the United States for two years,” he said. “Now we think [the U.S. market] is interesting again.”

Shapiro said the joint venture it has with Hovnanian also has been a good one. “Hovnanian is way ahead of projections. We are thrilled with that one,” he said. “We think the market has really picked up a little bit, and there is a real lack of liquidity that exists now for home builders.”

Shapiro said GoldenTree doesn’t wait for builders to provide proposals. Rather, it determines which markets it is interested in investing in and then does research to determine which firm might be the best local building partner. While GoldenTree isn’t exclusively looking for private builders, Shapiro said those types of home building firms offer the best opportunity for GoldenTree because the private companies don’t have the access to capital that the publics have.

Avila, who introduced LGI to GoldenTree, said other private equity money is also poised to invest in residential housing again. "It's a trend," he said. "But it's not for everybody."

Only strong players need apply. "It's not survival capital," Avila said. "It's only for certain builders who can get a return that's adequate. I think it fits those builders who can generate those returns in the [20% range] in IRR."