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The Heart of Texas

MHI partners up with Wilshire for double the fun in the San Antonio and Austin dance.

By John McManus

ED HORNE HAD BEEN IN HOME BUILDING SINCE THE 1970S, and with his recently deceased father-in-law Nash Phillips—one of the industry's true larger-than-life legends—he'd started Wilshire Homes in 1991.

That's at least three turns of Texas' boom-and-bust housing cycle roulette wheel.

So, Horne knew early last year that his options had shrunk. No matter that Wilshire had a strong name in Austin and San Antonio, and a strong name among partners, financial and otherwise. He was selling homes—he could take the contracts to the banks—but they were done fronting builders the funds to build. Without financing to go vertical, Horne and Wilshire might simply have been one of the industry's countless casualties, more of which we'll witness in 2011.

Horne dialed up dealmaker Tony Avila and asked him and his company "to start a process." The process drew interest from public builders, private equity funds, and at least two private home builders. It reached its conclusion in late March. Ed Horne—and three of the four lenders involved in Wilshire Homes' capital lines—agreed to have McGuyer Homebuilders, Inc./MHI Partnership, Ltd., acquire the assets, the operations, the brand, and the dynamo that is Horne himself to help the combined companies reach a new competitive level in San Antonio and Austin.

Making the two one in those two markets may give Austin and San Antonio a new Top 10 home builder in each. Clearly, where home building is showing even the faintest signs of resilience, the competition is cutthroat, the buyer pool can be lured out of apartments, and the opportunities to jockey forward in position come few and far between. For MHI, this one was bona fide. It offered the company an add-on operation that for all intents and purposes seems cut of its own cloth. Horne and the Wilshire name have deep-rooted equity among home buyers and their friends, among trade partners, perhaps most important as prices continue to reset lower—developers and land sellers.

What MHI got was a name it could love, a human face to it, a set of relationships that came with both the Wilshire name and Horne, and an operational approach that speaks essentially of flexibility, scalable semi-custom home building. For Horne and most of his Wilshire team, it was a company that bought their program as well as their assets.

The deal encapsulates three ideas of the moment that we're seeing happen in different ways in the home building market: 1) private home builders—by being able to act decisively—can outmaneuver public builders at one of the more critical challenges, which is seizing the right land assets for the right price; 2) the ongoing viability of the private home builders is taking shape even as publics become dominant in the volume game—if a private is positioned and segmented to meet needs that a public can't, it can grasp a foothold on a future; and 3) sometimes, given the fact that home building companies are personality-driven ventures where pride, passion, and an instinctual sense of purpose play a huge part, deals revolve around more than dollars.

Like this one. If dollars alone mattered in the outcome, a public home builder might well have dangled the most cash, and seller Horne may have taken it and prepared to turn his company over and get ready to spend more time fishing, sooner or later.

But in Texas, home building's truly a breed of its own. From DFW-based world-dominator D.R. Horton to Horton's indomitable mini-me—Eric Lipar's LGI Homes; from the course-corrected and redirected Grand Homes to the full-speed ahead Landon Homes; from the world-class David Weekley Homes to the regional power players Highland Homes and First Texas, building homes in the state that grew by 25 million folks since the prior census in 2000 and has far less of the regulatory encumbrances than other big states is a one-of-a-kind business.

Ultimately, what this means, even in this day and age, is that a handshake among trusting and trustworthy individuals can literally be worth millions of dollars, both on the savings side of the ledger and on the income side.

“[Between MHI and Wilshire Homes] we have a huge pile of goodwill built up among developers and land sellers,” says Ed Horne. “That store of goodwill can and will pay off for us in spades.”

In the limbo that is housing today—where shaky consumer confidence, weak home values, an ongoing slew of distressed resales, a maybe-maybe not jobs recovery, and a housing finance system subject to a paroxysm of political and financial services industry self-absorption, greed, and calumny—trustworthiness itself can allow a company to price a new home in such a way as to make it stand out in its market and sell.

The “well-priced” lot is virtually the mantra of the industry right now, and that's partly because with so many factors and drivers in flux, it's impossible to know what one of those is, except possibly in hindsight. All that people at companies do know is that, under certain circumstances, they can pay a good deal less for a home site, which may or may not be low enough a price to induce a buyer to snatch it up once there's a home on it.

So rather than business science, this moment in home building seems better described in terms of alchemy or, perhaps, high-stakes card play.

In fact, after all, MHI co-founder Frank McGuyer can actually utter these words with all honesty as the reason he's planning to stick around and work on a “next level” for the newly combined MHI and Wilshire: “I'm still having fun. The people I've been able to surround myself with as we built this company, many of whom are still on board, make me feel fortunate that I'm in this business.”

McGuyer's flinty capacity to thrive in hostile circumstances doesn't come from nowhere. The genesis of McGuyer Homes traces to 1988, when he and co-founder Mike Love were relieved of their jobs as division presidents of the now-defunct General Homes (which after a second Chapter 11 filing went in an assets purchase to KB Home in 1999). Their first full year of operations in 1989, they delivered 100 homes.

By 1993, MHI had closed on 1,100 units and had solidified a company culture that centers on customer care.

When somebody's in business because they're having fun at it, it's infectious. Others want that. The way that this particular deal penciled well went beyond what spreadsheet analysis would reveal. A go-forward pro forma in Excel is not going to tell anybody what having an Ed Horne on board will mean as you map your strategy to up your ante in Austin and San Antonio. But a guy like Frank McGuyer, who bases a fair amount of his business instinct and initiative on being trusted and trusting, can say what it's worth to shake Ed Horne's hand and take the game to a new level.

The only surprise was that the banks Wilshire owed money to agreed.

MHI president Gary Tesch first met with Horne last July. It was what the business calls a “beauty contest,” and, on Horne's mind was what amounted to three options his company's financial straits forced him to consider: 1) sell to a public, 2) give over control of the company to a private equity investment company, or 3) try to structure a deal with a private home builder.

TEAM MHI: From left, William "Mac" McKinnie, general counsel; Ed Horne, senior vice president, MHI Central Texas; Wade Bradow, division president, land acquisition; Denny Garrett, region president of Dallas, Fort Worth, Austin, and San Antonio; Gary Tesch, president; James Miller, region president of Houston; David Bruning, CFO; and Keith Faseler, division president land development.Photo: Phoebe Rourke-Ghabriel

The first two, given the fact that he brought a great name and deep land-access ties in two of very-early-recovery's hottest new-home markets, were most certainly worth some thought, at the very least because he “aligned” interests that would amount to a combination of forces in the two fiercely competitive markets.

Tesch and Horne struck a chord with one another on exactly three resonating inalienable truths: 1) home building is a people business, not a product manufacturing business; 2) customer care, including the flexibility to do what a customer asks for, is what a private home builder can offer that most higher volume public companies can't; and 3) that relationships with developers and land sellers is one of the parts of the secret sauce of a successful private home building company, since they'd yield not only prime locations, but terms to ensure value for land seller, builder, and home buyer in the equation.

In other words, a literal part of the "currency" of Horne's sale to MHI was trust. Horne looked across the table at Tesch, who was there at Horne's Wilshire headquarters in Austin speaking for MHI founder McGuyer, cut of the same cloth as Horne, and Horne knew he'd found what seller and buyer hope to find at that moment. A fit.

McGuyer and Tesch run an operation across five Texas markets—Austin, Dallas, Fort Worth, Houston, and San Antonio—the likes of which key senior management likes to come aboard and stay for a good while. The leadership team has an average of 19 years' tenure, and 30 percent of the associates at the company have been there a decade or longer.

At the strategic core is a long-running, well-established brand segmentation tiering system that, while McGuyer admits is an expense on the marketing and advertising end of things, has served to secure discrete reputations among separate buyer groups. Plantation Homes is the more widely recognized brand and featured in many MHI communities, aimed at first-time move-up buyers' needs. Coventry Homes is MHI's signature brand, with designs that accommodate larger lots and fit the needs of a sophisticated buyer with luxury appeal. Carmel entered the brand portfolio in 2006 for an urban, in-town townhome and luxury collection. It's available in the Houston and DFW markets exclusively. Pioneer Homes represents efficient, well-built homes for the first-time buyer.

Now, Wilshire offers custom elements and great opportunities in the San Antonio and Austin markets. Wilshire's build-on-your-lot operational approach gives MHI a new level of flexibility in meeting an evolving customer need and demand.

"A key to being a successful private home builder is the ability to adapt to local conditions," says new partner Horne. On an enterprise basis, that means being able to "respond quicker, and do it at the local decision-making level to grab an opportunity when it's first there," he says. What it also means is that on a unit basis, now MHI can be even more accommodating when it comes to stretching or adapting floor plans to the varying needs and desires of their customers. Driving the volume building formula to greater heights of flexibility is an advantage, particularly as buyers hail from evolving household compositions, alternative families, multicultural backgrounds, and a host of other variables that impact need for a wider array of basic choices.

A newer strand in MHI's strategic DNA is a customer-centered offering of higher-energy performance as a platform for all of its homes: Eco Smart.

“We give each market the flexibility to adapt it,” Tesch says. “Our Houston division partners with Environments for Living, which provides the homeowner with a three-year energy use guarantee to heat and cool their home; in DFW we are committed to LEED and enhance it with a guarantee of heating and cooling costs through the Efficiency Promise program, and we'll do more than 300 homes through that program.”

Add to MHI's brand portfolio and its emphasis on the money-saving value of energy savings, the latitude the company gets through Wilshire disciplines to adapt plans more efficiently to the customer, and it's understandable how the company's leaders anticipate a win.

“On a long-term basis, our Austin and San Antonio operations will together do about 600 units, worth $200 million or more,” says Tesch.

By the time the deal had solidified in spring 2011, it became one of home building's emblematic stories. Quite unusually, MHI's acquisition of Wilshire is a private-to-private transaction rather than the more typical public gobbling up of a private builder to ingest the market share and local knowledge position.

Too, MHI's assumption of Wilshire debt on an ongoing basis with agreement from three out of four Wilshire lenders, illustrates an unusual vote of confidence on the part of those three lenders—International Bank of Commerce, Royal Bank of Canada, and Texas Capital.

Tesch says he and his then new financial partner Dan Green, a principal at private equity investment firm Wheelock Street Capital, entered the Wilshire courtship process Avila set up thinking they were going to need to bring a lot of cash to the deal to pay off Wilshire's loans.

Instead, for this particular transaction, the banks wanted in. For once, trust seemed a more lucrative alternative than distrust.

If only from the vantage point of hindsight and geographical distance, the central theme line for private home building in 2010 carrying into 2011 would have to be a venal one: money.

The “score card” for private home builders, in other words, revolves around financial survival—no mean feat in a new-home universe that got struck by lightning in 2006 and came to in 2010 a fifth the size of its former self. Face it, if you subtract 25 percent of the 353,000 homes Hanley Wood Market Intelligence forecasts to be sold in 2011, and chalk them up to the share public home builders will do, that leaves a grand total of about 260,000 homes for all the private home builders in the country to build and sell for the year.

Consequently, by the end of 2010, the survival score card began to morph, and financial viability began to look more complex for those builders who in fact are viable, and more clearly impossible for those who are not. The credit squeeze on small to medium-sized businesses—especially in residential real estate—has converged with the credit squeeze on households who're still constrained in their spending and access to borrowing based on over-leveraged household balance sheets and destabilized income.

Together, those two forces mean the jig is up for private home building companies who've hung on a wing and a prayer through the darkest of the Great Recession's hours. Banking and real estate assets' era of extend and pretend is coming to an abrupt end.

Simply, if a privately capitalized home building company took in enough revenue to make timely payments on construction project financing and paid down land acquisition and development loans, including any infusions necessary to keep loan-to-valuation covenants current, and had enough left over to reinvest in building and lot takedowns, it could remain a going concern. If not, not.

Now, however, the plot thickens. Anticipating that home buyer demand is finally about to start its long way back to recovery over the next 12 to 24 months, home builders—public and private—have to put capital in place to ready home sites and open communities in sync with demand. Risk is back. So, a handshake with someone you trust can go a long way.