



Mastering the Product Mix

(Left) Legend Homes diversified into condominiums at The Q in Hillsboro, Ore., and (center) into townhomes and paired, stacked flat units at Stonewater also in Hillsboro, Ore. (Right) A 16-story condominium tower in Portland, Ore., called 937 is Patrick Kessi and Geoff Wenker's first high-density development.

Making the ^{leap} from single-family

By KJ Fields

Branching out into a new market is an exciting prospect. With opportunities for growth and the thrill of a new challenge, the lure of diversification is a strong one. Builders who successfully forge into new territory often take differing approaches, but they tend to agree on one point: Making the leap is not for the unprepared.

WHEN TO MOVE FORWARD

Homebuilding offers a good foundation for those wishing to try something new according to M. "Mike" Weiss, former chair of the Remodeler's Council and a life director of NAHB and owner of Carmel, Ind.-based Weiss RCMI, a firm involved in residential remodeling and construction, but he cautions that builders should be sure they have enough mettle—mentally, physically and financially—to support another endeavor.

"Make sure your organization's current base is big enough, strong enough and talented enough to take on something new. You don't want to overextend your people," he says.

Weiss also points out that the learning curve of

incongruent efforts will sap time and energy away from existing operations, so builders should diversify into areas that are compatible with their current business.

Weiss's former company entered a range of markets over the years including commercial, retail, industrial, custom homes and remodeling. His most important tool was a formalized plan with a timetable and a deadline for attaining various levels of achievement.

"You have to have proof points along the way so you know when you are hitting your mark and when to bail out. You can't manage what you can't measure," Weiss explains.

Although a softer market may give single-family builders a prime opportunity to diversify into multifamily construction, Weiss believes no one should try to diversify when the economy is flat.

"That's not diversification; that's scavenging. The time to diversify is when you're doing well but have the foresight and intelligence to add something profitable and challenging to your present skills," Weiss says.

RELATIONSHIPS OPEN DOORS

Brett Bruchmiller, principal of Boulevard Builders in Dallas, Texas, says he and his partners focused their early efforts on urban townhomes, but always planned to expand their product mix in order to keep the business strong.

"It's fundamental for midsized builders to broaden their markets. With market volatility, it's not a good idea to have all your eggs in one basket," he says.

Bruchmiller believes those interested in diversification should build connections in specific locales. Brokers will begin to know and trust you, which fosters opportunities. This approach takes time, but Bruchmiller believes it generates quality prospects. When an opportunity arises, his partners evaluate it based on how well it fits into their base of expertise.

"We're here for the long haul, so we're not going to chase every deal. No matter how good something looks on paper, we won't pursue it if it won't do right by our customers."

Boulevard Builders provides a lifestyle in what



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they build, and they look to grow their product line within that framework. The company's most recent diversification is in single-family detached, lakeside second homes. Currently, they are examining six possible sites, some as joint ventures with the landowners. The product attracts buyers looking for a quality of life similar to the townhome buyers they're already working with, but who want maintenance-free, highly amenitized, resort homes. Knowing how to serve needs of that client base and seeing the new market demand presented a compelling case for their expansion.

Although Patrick Kessi, owner and developer of 937 Group, LLC in Portland, Ore., started out buying and remodeling homes, he realized that building condominiums was a way to manage his time more efficiently. With no knowledge of commercial construction, he formed a partnership with Geoff Wenker who had been a general contractor. Their first project as developers was a 17-unit, five-story property. Then they decided to locate a 16-story, 114-unit condominium tower, called 937, in Portland's trendy post industrial Pearl District. Kessi realizes it is a bold move, but he relied on the relationships of his team for expertise.

"Surround yourself with the best team you can and hire people that are very experienced in the product type you're moving into. Talk to a range of brokers that make that product their business," says Kessi. "The team we created really helped our expansion."

Creating relationships with a team of experts that includes architects, engineers and land plan-

ners will reduce risk, says Dan O'Malley, partner at BSB Design's Chicago office. With the right people available, a builder can gain access to the insights and informed opinions necessary for quick decisions.

According to O'Malley, most single-family builders in the Chicago area are savvy enough to know their portfolio needs to include multifamily work as well. Infill work offers great possibilities, and one way to get started is to establish relationships with the city's community development staff or a village manager. Many cities are replacing their industrial buildings closer to the urban area with new residential developments, and knowing the people involved in this process is valuable.

"Infill sites are all around and they allow you to

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open up a whole new business model. Look for sites that aren't performing up to standard. Be creative and assemble a parcel," O'Malley says.

AVOID PITFALLS

O'Malley has seen builders encounter pitfalls when they don't understand the differences in the product types. Multifamily properties require fire separa-

tions, sound separations and typically have more costs involved. He also notes that ownership structures vary and a builder needs to know the distinctions between a fee-simple property or a condominium, as well as the nuances of organizing a homeowners' association. Many builders also underestimate the time it may take to rezone a property, as an important or contentious site can wait 12 to 15 months for rezoning. Once approval is obtained, builders need to reassess if their market assumptions have changed.

Because a lender will look at marketability and a host of lending criteria, a builder should consider all the aspects of the market, competition and product sales strategy as the first line of defense. Poke holes in every good idea to see if it can stand up to scrutiny. In addition, be very conservative in your underwriting to reduce the opportunity for contingency hits.

Kessi says part of his learning curve was that he didn't always allot enough time to get things done. Builders entering new markets need to learn every step involved and plan in advance.

"Project what needs to happen and keep those items in front of you throughout the process so your project doesn't get put on hold," says Kessi.

Rudy Kadlub, CEO of Costa Pacific Communities in Portland, Ore., warns builders against adopting a "me too" mentality when diversifying. When many builders begin to copy one another, the market becomes saturated.

"Builders need to ask themselves what's coming, not just what's selling today," advises Kadlub.

"Even a new idea requires time for the product to get to market, so you need to know what's in the pipeline and how much competition there will be when your project comes on line."

Developer of the award-winning transit-oriented community Orenco Station, Kadlub is now entering markets in Boise and Sacramento, but



he's made very calculated choices about what he will build. He believes the ease of obtaining a permit in places like Sacramento, Phoenix and Boise, combined with greed and overexcitement, has created overbuilt markets that are in a bloodbath right now. By doing deep market research, he is able to offer products that speak to a need in the marketplace and remain successful.

MARKET RESEARCH

Every market is different, so very specific research is required. The geographic location, proximity to urban areas and demographics all come into play. Effective market research will help determine what should be built, according to Kadlub. For example, in Boise, Costa Pacific is creating a new development downtown, as the suburbs are overbuilt. In Sacramento, he's building on the light rail line since transit-oriented development hasn't occurred there.

"Know the depth and breadth of your market. Find out what people perceive as value and what they are willing to pay for the product you're considering," he says. "As people delay the onset of marriage and the divorce rate continues, people are staying single longer and having fewer children. Years ago, we recognized that translated into a need for smaller household sizes."

President of Legend Homes in Portland, Ore., Jim Chapman says that as his company began to diversify, he then studied potential buyers to find out exactly who was not being served.

"We found a killer location and really wanted to be there, but we didn't like the prospect of putting something up and seeing if it would sell," says Chapman.

Legend Homes went from building single-family detached homes to paired, stacked flats and townhomes in a 346-unit development called Stonewater at Orenco Station. Based on their research, they designed the development for a mix of singles and couples, including empty nesters and single women at a time when no one else was targeting this demographic. The project was wildly successful. They aimed for even higher density with their second Orenco Station project, The Q condominiums.

Chapman says it's important to be comfortable with who your buyers are and where they're coming from. Once you've got your research in hand, it's essential to trust those numbers and stick to your original plan.

"With attached housing, you have to build the entire project. There's no sectioning it off once you begin, so you're taking a greater financial risk," Chapman explains. "If you get nervous and deviate from what your research tells you, your ready-made market is gone. At that point, you're gambling."

KEEP YOUR BALANCE

Warren James at Edward R. James in Glenview, Ill., thinks builders need to understand their customers first and foremost in order to deliver the product they're seeking. He's seen builders focus on a particular market segment and miss opportunities right in front of them.

"You've got to build to the market or you'll

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stand on the sidelines. When you recognize an overlooked land opportunity or the possibility for redevelopment that no one else has seen, that's the time to make a move."

James affirms that builders have to do their homework to know how much the venture will cost and where the buyers are, but he says that's only one part of the equation.

"You can survey the market and do an excellent job on assembly, but if your design isn't something that speaks to your target, your product won't survive," James says. "Successful product development relies on three elements: design, specification and execution; and all of these need to be addressed with equal care."

Edward R. James began building mid-rises in Chicago but saw the risk of having to complete the entire project in order to realize its value, which led them into multifamily suburban projects. Their ability to manage processes with the individual customer sparked diversification into development consulting services for high-rise construction projects. The company performs sales and marketing, product selection and coordination, and construction management for large-scale developers.

"We provide the high-touch aspects of the job," says James. "We interface with both the buyer and contractor to make sure expectations are met."

When it comes to their stick-frame townhomes, however, Edward R. James remains a vertically integrated company.

WORTH THE RISK

Some builders assert that diversification is necessary to add breadth to their portfolios, while others like Kessi used it to evolve into new careers.

Diversification can take place on a more subtle level too. The best place to diversify might be within a builder's existing product line. Retooling your current products in order to respond the customers' changing needs can distinguish a builder from the competition without having to find a new niche.

Diversification keeps people flexible and open to new ideas. Learning about new aspects of business and development can make builders better in all of their market sectors. With proper preparation, builders can minimize their risk and make forays into new markets to invigorate business and strengthen the company's overall base. ■

BUILDERS' DIVERSIFICATION CHECKLIST

- Make sure your organization can handle the change.
- Stay within your expertise or develop a professional team of experts to guide you.
- Build relationships with brokers and city representatives.
- Look for underserved markets and find out what's already in process.
- Conduct extensive market research.
- Be very conservative in your underwriting.
- Balance product design, specification and execution.
- Have your construction quality procedures down pat.