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# For Single-Family Builders, Going Vertical Carries Risk

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NEW YORK -(Dow Jones)- Two single-family home builders who decided to "go vertical" are about to find out if they are late to the nation's condominium party.

Toll Brothers Inc. (TOL), famous for its sprawling McMansions, has 10 buildings 12 stories or higher under construction, with eight more on the drawing board. Hovnanian Enterprises Inc. (HOV) is building its first high-rise tower, the 48-story 77 Hudson in Jersey City, N.J., which should be finished next fall.

The projects were planned before the housing bubble burst. Now, several of the buildings will hit the market during the longest and deepest housing downturn in decades and enter a lending environment that is becoming particularly hostile to condos.

Mortgage giant Countrywide Financial Corp. (CFC) said at one point recently it would stop approving its "Fast & Easy" and Alt-A program loans for high-rise condo units, although it quickly reversed that decision, according to brokers. Some other lenders have halted condo loans, particularly in overbuilt South Florida and Las Vegas, where property values are plummeting.

Both New Jersey-based Hovnanian and Pennsylvania-based Toll say most of their projects are in and around the robust New York region, which has so far been buffered from much of the housing downturn.

But the Big Apple's shine could be fading: Housing's ails have spilled into the nation's largest banks, fueling big losses and thousands of layoffs, winnowing the Wall Street bonuses that have long fed the market.

While interest from foreign buyers is picking up, "there are definitely some economic concerns on the horizon," says Shlomi Reuveni, senior managing director and executive vice president of real estate company Brown Harris Stevens Select.

So far, Reuveni and the developers remain optimistic. Toll's condo deals accounted for between 5% and 8% of 2007 sales, and the company projects their growth to be 10% to 15% of sales in the next five years. In conference calls, Toll consistently says the condo market in the New York region continues to do well.

Condo sales "may be off the highs that we had, perhaps in 2004 (and) 2005, but we have not experienced the lows that other areas of the country have experienced," Ben Jogodnik, senior vice president for Toll's City Living division in Hoboken and Jersey City. "Our market - knock on wood; I'm looking for some wood here - continues to be very, very steady."

Of the 376 units being built at Maxwell Place, the former Maxwell House coffee factory in Hoboken where residents are expected to start moving in this summer, 90% are under contract. (The first 169-unit phase sold out almost immediately in late 2004.) The 230-unit 700 Grove in Jersey City, which opened for sales during the housing heyday and is set to be finished this fall, is 85% spoken for.

Hovnanian, meanwhile, reports that about 25% of 77 Hudson's 420 units are taken. The sales pace - a dozen or so last month - "continues to well exceed our expectations," the company says.

Success with their condo towers would be welcome to the battered builders, which have seen cancellation rates on single-family homes soar, while gross margins and selling prices have fallen. Condos let builders tap markets where it might not be possible or cost-effective to build single-family homes. Since condos are more expensive to build, the units carry hefty price tags: 77 Hudson's prices, for example, range from about \$400,000 to \$2.75 million, the latter being well above what Hovnanian's single-family homes command.

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Prices at Toll's Maxwell Place range from the mid-\$500,000s to more than \$3 million.

"In order to be successful and ensure continued growth, we have to diversify product types," says Randy Brosseau, Hovnanian's metro New York area president. But, for this, he adds, "The level of risk is higher."

Condo projects are usually in urban areas, where land is expensive and rarely undeveloped. Also, they require spending serious money upfront - neither Hovnanian nor Toll would say exactly how much - for a payday later.

Wall Street isn't enthusiastic about condo towers at the moment. "You're talking about tying up several million dollars at a time and not getting paid for several years," says Joe Snider, a senior credit officer at Moody's Investors Service.

Moreover, once construction starts, it is nearly impossible to pull back if market conditions change, a key difference from single-family communities where the developer could simply build fewer homes.

With houses, "You would basically wait with the land until the market comes back," Jogodnik says. "In high-rise, you can't do that."

Also, during condo construction, developers have little idea how many contracted buyers will end up closing, so they could be saddled with unsold units - and possibly debt - upon completion.

"You've got to have some long-term financial strength to be able to carry the expense of that high-rise ghost town until you've sold it," says John Fioramonti, senior managing director of Meyers Builder Advisors, a real-estate consulting firm.

That is assuming people actually move in. Like Toll and Hovnanian, Florida-based WCI Communities Inc. (WCI) announced a condo tower, One Bal Harbour, in better days. But in the time it took to build the luxury project, the market collapsed: One consultant says the area now has a 61-month condo supply, with tens of thousands more units set to flood the market, which means severely depressed prices. WCI executives have said the tower is crucial to free cash flow, but as signed buyers get jittery and the company does little to reassure investors, the company stock has fallen more than 80% in the last year.

Meanwhile, dozens of units are available at Lennar Corp.'s (LEN) waterfront 360 project near Miami, the company's first Florida tower. Lennar, one of the nation's largest builders, is advertising a block of unsold units to institutional buyers, says Peter Zalewski, a broker with Condo Vultures Realty LLC in Florida. That block is "an indicator to me that the thing probably wasn't as successful as they had hoped," he says.

Hovnanian's Brosseau says, "There's no guarantee of any project's success. You hang your hat on the best locations."

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(Marshall Eckblad contributed to this report.)

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