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More Heartache for Housing

Bad news piles up for the sector as homebuilder Ryland warns of a big loss and an industry group issues gloomy forecasts on sales and prices

by [Karyn McCormack](#)

Warnings from homebuilders continue to pile up, indicating that a bottom in the housing downturn is still nowhere in sight. Ryland Group ([RYL](#)) became the latest victim on July 11. The Calabasas (Calif.) builder warned that it expects to post a sharp loss because of the continued deterioration in the housing market.

Ryland said it expects a second-quarter loss of \$1.25 to \$1.35 per share and expects to take additional charges of about \$145 to \$155 million related to inventory impairments and write-offs associated with assets in Arizona, California, Florida, and Nevada. Excluding inventory impairments and write-offs, the company expected to earn 70 cents to 80 cents per share during the second quarter.

Ryland said preliminary sales for the second quarter were 2,521 units, down 16.6% from a year ago. Cancellations were around 34% of orders for the quarter.

POOR OUTLOOK FROM ANALYSTS AND INDUSTRY

"We foresee slow demand for new homes and potential for more write-downs into 2008," said Standard & Poor's equity analyst Tom Smith in a note, adding that he had expected Ryland to earn 32 cents per share in the second quarter before its warning. He downgraded Ryland shares to strong sell from sell and cut his 12-month target price by \$2, to \$31. Smith also slashed his 2007 earnings per share estimate to a loss of \$1.35 per share from \$1.20, and his 2008 forecast to \$2.60 from \$2.75.

Adding to the sector's woes, the [National Association of Realtors](#) trimmed its existing-home and new-home sales forecasts on July 11. The trade group also predicts that median prices will drop 2.6%, to \$240,100, for new homes and by 1.4%, to \$218,800, for existing homes this year.

Ryland shares fell 0.7% to \$36.04, on the New York Stock Exchange on July 11, not too far from their 52-week low of \$33.86 reached July 18, 2006. Homebuilders' stocks have been heading downhill after a brief recovery early this year. The S&P Homebuilding index has dropped 25.5% so far this year through July 6, on top of a 20.6% decline in 2006.

CONTINUING SUBPRIME FALLOUT

The news came a day after worries about the subprime mortgage mess spread when Standard & Poor's Ratings Services

and Moody's ([MCO](#)) said they plan to downgrade billions of dollars worth of mortgage-backed securities, causing a drop in stocks and bond yields (see BusinessWeek.com, 7/10/07, "[Stocks: Another Subprime Stumble](#)" and "[S&P Warns on Subprime-Backed Issues](#)"). Said S&P in its report: "We expect that the U.S. housing market, especially the subprime sector, will continue to decline before it improves, and home prices will continue to come under stress."

Also on June 10, homebuilder D.R. Horton ([DHI](#)) warned that it expects to post a third-quarter loss as the "challenging" housing market continues. It posted third-quarter net sales of 8,559 homes (\$2.0 billion), vs. 14,316 homes (\$3.8 billion) for the year-ago period. D.R. Horton admitted that inventory levels of new and existing homes remains high.

"We view a 38% order cancellation rate as weak even within the context of a multi-year housing industry slowdown," said S&P's Smith in a note about D.R. Horton. "Average selling price per home fell about 12%, which should contribute to what the company describes as 'significant asset impairments,'" he added. He kept his sell opinion on D.R. Horton shares, and lowered his earnings estimates and 12-month target price to \$17 from \$18, based on updated price-to-book analysis.

AGGRESSIVE SELLING HASN'T CUT INVENTORY

Considering the bad news, Smith also downgraded shares of homebuilder Centex ([CTX](#)) to sell from buy on July 10. "We are taking a dimmer view of prospects for CTX as peer reports describe intensifying price competition amid a housing industry slowdown we project will last into 2008," he said in a note. "Lower average selling prices for homes increase the potential for inventory writedowns, in our view."

The housing market remains the major risk to the U.S. economy, said David Wyss, chief economist for S&P, in a July 9 report. He noted that housing starts have held up better than expected through the first five months of 2007, thanks in part to builders cutting prices to sell homes. "Although the data do not fully capture the extent of givebacks, add-ons, and cut-rate financing, it is clear that builders are pulling out the stops to get rid of unsold properties," he said.

Still, the inventory of unsold new homes has risen to a 7.1-months' supply—which he thinks is likely to further depress housing starts in coming months—and then possibly bottom during the winter. The recovery next year will be weak, with starts up only modestly from the 1.4 million expected for 2007 (down from 2.07 million in 2005), Wyss said.

REBOUND IS AT LEAST A YEAR AWAY

He doesn't expect home prices to bottom out until the spring of 2008—with the Standard & Poor's/Case-Shiller index of home prices in the 20 major metropolitan areas dropping by a total of 8% by early next year from its peak in the spring of 2006. And until the inventory of unsold homes is reduced, prices are not likely to revive until late 2008, Wyss said.

What's more, Wyss figures loan losses and foreclosures, which are lagging indicators, are not likely to peak until late 2008 or early 2009. Though pinpointing the bottom of the housing market isn't easy, it seems conditions could get worse before they get any better (see BusinessWeek.com, 6/27/07, "[The Housing Mirage](#)").

McCormack is senior producer for BusinessWeek.com's Investing channel.

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