Preparing for a Downturn

A column series

by Scott Sedam
In both 2018 and 2019, the annual Zillow Survey of 100 housing industry authorities predicted a housing slowdown beginning in the first quarter, 2020. Is it true? You can read something different each day it seems. Builder confidence is up ... or down. Consumer confidence is down ... or up, Millennials are not buying ... no, wait, actually they are! Permits are up in some markets, down in others. There is structural, demographic demand for at least 1.5 million units, yet we are selling only around 1 million. On one hand, that should mean unlimited opportunity. On the other, the analysts show we are over-priced in every market segment.

The only thing we know for sure is after a 10 year expansion from the depths of the last housing recession, things have to slow down at some point. We just don’t know when. Regardless, we need to be prepared. This series of 3 columns tries to answer the question of how to prepare, or at least get a builder started. The first is a big picture view, featuring three categories of cost and inefficiency that must be addressed. Column two gives input from ten builders who survived the last big slowdown. Column three features one of the most experienced veteran builders and survivors of all, George Casey.

The irony is most of the recommendations you’ll find in these columns constitute good advice for good times – or bad. I hope you’ll find these ideas on preparation helpful and I welcome your input and feedback.

1. The Next Housing Downturn – Is it too late to get ready?  
   **July 2019**

2. Survivor! Home Building Edition  
   **September 2019**

3. Lessons Learned from a Downturn – Can they help us next time?  
   **October 2019**
THE NEXT HOUSING DOWNTURN—
IS IT TOO LATE TO GET READY?

IT’S TIME TO GET UP, SPLASH SOME COLD WATER ON YOUR FACE, AND STARE DOWN THAT PREVIOUSLY CONFIDENT IMAGE IN THE MIRROR. ARE YOU READY FOR THE DOWNTURN?

By Scott Sedam, Contributing Editor

A few weeks back, I read a provocative statement by a home building pundit. In so many words, this authority declared that unless a builder began two or three years ago, it is too late to prepare for the next downturn. If a builder is sitting on a big land purchase needing three, four, or more years to secure entitlement and start production, our expert has a point—there’s nothing like breaking ground just when the market slows or sitting on a mountain of unproductive fixed assets in the middle of a downturn. The impact is no different than a shuttered manufacturing plant—all that capital sitting around, doing nothing but generating carrying costs.

Excess land/lot inventory was the most obvious factor that took down so many builders in the last great housing crash, which reached its low point a decade ago. Back in my national builder days, the debate over buying large tracts of land for development versus phased “takedowns” at a contracted price raged on endlessly. Yes, you pay a considerable fee for lot options, which increase your finished lot cost and take away a chunk of your profit. The takedown strategy, however, protects a builder, reduces risk, and allows a much nimble response in a down market. On the other hand, in good times, the builder that buys and holds land for production will nearly always make more money. Then again, in bad times, a large land/lot bank can eat you alive. And so it goes …

Where are we now in the current market cycle? When does the next downturn arrive? Is it really too late to prepare? Around the country today we see flat to slow growth in most markets with good cash flow, yet reduced profit margins. The increased cost of raw land, entitlement, development, labor, material, and overhead, combined with the nationwide trade shortage, drive the biggest concern of all: housing affordability. Simply put, according to most market analysts, we are overpriced at every level—not an easy problem to solve. Can we reduce sales prices when margins are already compromised?

From most accounts, there are no imminent signs of a major downturn in 2019. In fact, recent surveys show builder confidence is up (see page 13). The structural demand from population growth and replacing dilapidated housing is typically estimated at around 1.6 million units annually. That’s half a million more units than we are currently building, so the latent demand bodes well for housing—if we can solve the affordability conundrum. Interest rates are low, people are working, wages are rising, but there are looming threats from tariff wars with China, Mexico, the European Union, and who knows where else by the time you read this. Now add in the rapidly
growing, record federal spending deficit. At some point, we’ll have to face up to this reality, and it won’t be pretty.

After surveying 100 economists and real estate experts, online real estate pioneer Zillow published a report in May 2018 concluding that the target date for the next downturn is first quarter 2020. One year later, in May 2019, Zillow ran the survey again, and the consensus held: an expected slowdown in Q1 2020. That’s just six to nine months from now. Given all of the positive factors out there, can this be?

I know one strong, quite large builder that decided to cut its exposure last year and intentionally pulled back its number of 2019 forecast units by a third compared with 2018. Are they kicking themselves now? They absolutely could have sold more this year and made more profit, but what is the cost/benefit of preparation? Will their caution prove an investment or an expense? Only time will tell, but now it’s time to get up, splash cold water on your face, and stare down that previously confident image in the mirror. Are you ready for the downturn, whether it arrives in early 2020 or holds off for another few months or even years? Is it possible to reap the benefits of the current market, yet still prepare for the slowdown?

No matter their land/lot situation, who would tell a builder there is nothing they can do? Any builder with the backing to make land purchases of a size that can pose a danger already has significant production in progress and thus has almost unlimited opportunities to prepare for the downturn—without compromising current sales. In fact, they can improve both current sales and margins while simultaneously getting ready.

Flying in the face of “nothing can be done,” my TrueNorth colleagues and I have seen many builders of all sizes and types across North America make dramatic, systemic changes to their businesses within a year or even faster.

BREAKEVEN OR BUST

As I worked on a list of key strategies and tactics to help home builders prepare for the downturn most believe will come, I thought back over some of the discussions I’ve
had with builders and other consultants during recent conferences, builder club meetings, and client visits. The venerable concept of “breakeven point” keeps raising its head.

Is there any better way to organize your thoughts and actions to prepare for a weakening of the market than thinking in terms of how many units you have to sell to break even and how you can lower the number to guard against a slowdown or dive? It’s certainly compelling. At what point in a given year are all of the fixed costs covered? Consider a simple, classic definition of breakeven:

Breakeven point based on units: Total fixed costs divided by revenue per unit minus variable cost per unit.

Fixed costs don’t change, no matter how many units are sold. The variable costs per unit rise or fall with volume. Do the math and get your number. OK, how’s that working for you? Now, cut the number of units by a quarter or a third. Do the math again. Can you still breathe? If not, it’s time to get to work.

Fixed and variable are not nearly as clean as they sound. Thus a breakeven analysis, so straightforward in an accounting text, gets messy when builders classify fixed and variable in many divergent ways, and costs are often a mix of the two.

The classic example is the cost of a sales force. Recently, in a long discussion on sales compensation with four builders, three said they pay their salespeople salaries ranging from an intro of $35K to as much as $65K for an experienced representative, plus commission on top. They believe this is necessary to attract and keep the best people. The fourth builder pays 100% commission and is adamant it’s the only way to go.

Obviously, the builders paying salaries plus commission have a greater percentage of fixed cost, raising their breakeven higher. The fourth builder has 100% variable sales compensation. He carries less risk if sales slow, but the harsh reality is that salaried folks can be laid off quickly if required, so the fourth builder’s advantage is probably no more than a month or two. Yet builder No. 4 will indeed show a lower breakeven point.

I had a client once tell me all of his costs were variable—100%! This presumes total elasticity in all of your overhead including rent, salaries, insurance, the carry costs of your model homes, and even the copy machine. He asserted that each cost goes up and down exactly with volume.

I suppose we can conjure a scenario where this could be, but let’s not waste time on that because it’s not a reality for most builders. The key is absorption of the fixed costs—a concept pounded into my colleagues and me decades ago while working for the late Bill Pulte. Since most builders aren’t shrinking at this juncture, this means limiting any additions to fixed cost wherever possible. Can we build one more house without hiring anyone, buying equipment, or adding support staff? How about 10? Twenty? If so, absorption goes up and breakeven, relative to total volume, goes down.

Right now, I’d be very careful about moving into a new building at a higher monthly rent or making any investment in people, land, or capital equipment that can’t stand up to tough examination. Of course, there are exceptions. One client is not only bringing on new people but is hiring them far earlier than most builders, to facilitate more thorough training. He’s building in a unique niche, however, and makes a strong case for being more liberal with these costs.

Although historically I’m a big advocate of the long-term view, in consideration of the 2020 forecast, you must ask of each expenditure: Will this pay its way in the short term?

One problem with breakeven is accounting tends to treat variable costs as a set amount per unit, which rises or falls in exact proportion to volume. Sounds rather strange, but viewed this way, variable cost becomes, in a sense, a fixed cost per unit. We all know from experience this isn’t true. Labor and materials prices can vary significantly across months or even years of building a community. Bill Pulte used to preach, “Know and fix your costs! Know and fix your costs!” Those are still great watchwords today, but frankly, I think it’s tougher now than it was 20 or 30 years ago. Even in these times of still-rising labor, material, and overhead costs, we can’t fall victim to the assumption that
significant improvement isn’t readily available. Continual improvement of product and process through the application of Lean thinking and techniques—the relentless pursuit and removal of waste in product and process, which is bigger than but includes value engineering—is the best way to make this happen. Builders in every market are achieving such results, lowering breakeven, and feeling a lot better about what may come in 2020—or not.

**Strategies for the Downturn—and for Today**

Preparing for a downturn requires that each project you undertake be completely targeted, knowing exactly what you’re going to build and who the buyers are. Prove it. This isn’t a time for wishful thinking—or building.

Your finances, of course, must be in order. Reduce debt and refinance anything possible at a lower rate today, while money is cheap. Operationally, over the past years in multiple columns, I have described many avenues to reduce both fixed and variable cost per unit. Here are three I’ve found particularly powerful in the breakeven game.

1. **Variance reduction.** This qualifies as an industrywide epidemic in most locations. A lot of it began during the previous downturn, when, in order to sell a home, most builders were willing to change almost anything a client wanted. This was much easier at lower volume levels, but at today’s building pace, the resultant variance purchase orders (VPOs—aka FPOs, EPOs) are among the biggest profit killers. Awhile back I set out to write a column about the impact of variance, which was so big an issue that my column morphed into a series of four. The most important things to remember are:
   - No one, including your suppliers and trades, makes money on variance.
   - No builder in America measures variance fully or correctly. (They leave out overhead to the builder, suppliers, and trades—and that’s where the money is.)
   - Excess plans, elevations, and options are significant contributors to variance.

2. **Schedule and cycle-time reduction.** Most builders aren’t nearly as tight with schedules and cycle times as they were prior to the last big downturn. Sure, the trade shortage makes it hard, yet we know plenty of builders that have overcome it. A few key points:
   - Reducing work-in-process inventory of homes in production is a great goal for good times and is absolutely critical in a slowdown.
   - Reducing cycle time significantly reduces the load on field superintendents. You can do more with less.
   - A tight, predictable schedule is among the key factors for attracting top trades.

3. **Simplification (plans, options, design center cleanup).** Every option requires a thorough total cost analysis. Many are less profitable than you think.
   - Uncontrolled complexity is the enemy of quality, cycle time, and low variance.
   - Many design centers have grown beyond what’s needed to meet customer needs and aren’t as profitable as believed.

The one thing we absolutely cannot count on to lower breakeven in this market is increases in retail sales price. In fact, given that we are overpriced in each segment, exactly the opposite must happen. Daunting to think about price reductions, isn’t it? Yet the great majority of builders won’t tackle this issue seriously until the downturn is fully upon us. Will you? To reduce sales price and maintain an acceptable margin, you need to start today. Challenge every fixed cost and search relentlessly for every possible waste in the variable cost for each unit. Lower your breakeven point this year, so no matter what comes in the years ahead, it won’t break you.

Scott Sedam is president of TrueNorth Development, a consulting and training firm that works with builders to improve product, process, and profit. For a copy of this column as a part of the latest edition of Scott’s series, “Bridging the Margin Gap,” send a request via email to info@truen.com and include “Margin Gap” in the subject line, or call us at 248.446.1275.
HOW DO YOU PREPARE FOR A DOWNTURN?
BATTLE-HARDENED INDUSTRY PROS OFFER THEIR INSIGHTS AND ADVICE
n “The Next Housing Downturn—Is It Too Late to Get Ready?” in the July issue, I noted that many pundits and provocateurs predict a slowdown of some note in early 2020, and how one industry authority has proclaimed it already too late to prepare. I spent the remainder of that article detailing specific things builders can do to simultaneously improve their current operations and prepare for the possibility of a downturn. I developed those ideas watching and working with survivors of the last big crash, combined with what my firm, TrueNorth, has learned through more than 200 Lean Process implementations.

The next logical step: query some of those survivors and ask for their recommendations. What do they suggest builders do to prepare for what will come, sooner or later?

Their responses are interesting, ranging from common, expected themes to divergent opinions. These are the voices of experience.

**LARRY WEBB**
*THE NEW HOME COMPANY, ALISO VIEJO, CALIF.*

Larry is an industry legend, from his time developing John Laing Homes into a powerhouse and selling it just prior to the last big housing crash, to his launch of The New Home Company, now operating divisions in Northern and Southern California and Arizona. Here are Larry’s recommendations.

1. **Reduce your general and administrative expense (G&A).** In good markets, staff numbers get bloated and salaries escalate—in particular, look at your highest-price team members.

2. **Lower your leverage.** Whatever it is, reduce it.

3. **Save your cash.** Buy less land and save money for rainy-day opportunities.

4. **Refocus your team.** In good times, home builders can get into market positions outside of their wheelhouse and get away with it. In bad times, it kills you. Do what you do best, nothing else.

5. **Remember: Culture and people matter even more during bad times.** Evaluate everyone and focus on your stars at every level.

**DON HUBBLE**
*HUBBLE HOMES, BOISE, IDAHO*

Don Hubble, founder and president of Hubble Homes, is a straight-shooter, a solid builder, and is very involved in his Boise community. He keeps it simple, with this admonition: “I have one major belief,” he says, “and it’s probably the same No. 1 on everybody’s list: Don’t pay cash for land right now at today’s market value.”

**DAVE ERICKSON**
*GRAYHAWK HOMES, COLUMBUS, GA.*

While fighting the housing recession, Dave, the founder and president of Grayhawk Homes, also fought off much larger builders from Atlanta trying to nab a share of his market.

He was successful on both fronts and has this to tell you: “First, if you own a big land position, make sure your finances have durability. That applies universally, but it now becomes critical. Second, you must ask, if you had passed on that land position, who would have gotten it instead, and then what happens if interest rates U-turn on you, as happened during the first two quarters this year? Finally, if we do get a slowdown, as soon as you’re convinced it’s real, don’t be slow to cut costs and people. That was my weakness in the last downturn: I was too slow to adjust staff to the new reality.”

**SCOTT DIRKSCHEIDER**
*BROOKLINE HOMES, CHARLOTTE, N.C.*

Before launching fast-growing Brookline Homes in 2014, company president Scott Dirkschneider gained a wealth of experience with both national and local builders. His 40 years in home building, preceded by degrees in both architecture and construction management, give him a rare perspective.

Scott says: “I see many builders, especially the nationals, running around like Chicken Little, proclaiming ‘The recession is coming. Don’t buy land! Don’t buy any more land!’ It’s not too late to prepare for a recession, but it will be easier for some than for others. It surprises me the number of builders who seem to forget what they learned in the last recession. The smaller builders can actually prepare for a recession much more quickly and easily than the typical national. To survive,
we must become, then stay, Lean in every aspect. We have only 20 plans—I wish it was 10—across seven communities, and we purposefully offer very few options. If every buyer is asking for it, we make it standard and raise the base price. Our salesforce is commission-based, our variance to total cost is less than 0.2%. Our staff-to-home ratio is >13 homes per employee. We buy most of our lots on an option basis. Land will bury any builder that isn’t prepared financially for the next downturn. Finally, having gone through LeanWeek, we continue to discover new ways to improve product and process and apply Lean to our bottom line. Being Lean definitely gives us a leg up.”

**TODD BOOZE**  
**IDEAL HOMES (RETIRED), OKLAHOMA CITY, OKLA.**

As a co-founder and president of award-winning company Ideal Homes, Todd sold his share of the business to his former partners earlier this year and is now retired, although no one who knows Todd believes that will last for long.

A long-time examiner for the National Housing Quality Award, Todd adds a couple of items most others overlook:

1. **Technology:** “Many builders use multiple databases because employees create their own spreadsheets to manage their process, forgoing the fully integrated software they have because they ‘just don’t like it.’ We ran into that and it created a lot of work behind the scenes because people held on to their sacred cows. You must get your technology and databases in order.”

2. **The million dollar question:** “How many of these builders are working with their trades to help the trade improve, which in turn helps the trade’s relationship with the builder and results in better pricing? We have waste in our own systems for sure, but think of the cost of waste in our trades and vendors, in how they do things. I always try to work with individual trades where I see obvious problems and I discuss issues at meetings with them, but there is nothing better than going to their playing field and helping them. It’s tough to do; we have so much to work on in our operations. Yet there are tremendous opportunities if we help others get what they need, then we in turn will get what we deserve.”

**JOHN ALLEN**  
**BROWN HAVEN HOMES, BLAIRSVILLE, GA.**

John Allen is one of those visionary leaders who goes his own way, always thinking first of what he can do, instead of what he can’t. From its small-town north Georgia base, Brown Haven Homes is rapidly expanding its on-your-lot business into North and South Carolina, building great homes in beautiful settings.

John steps back to a macro level and asks some intriguing questions. “First, our margins shouldn’t be so thin as to dramatically alter the way we do business when the slowdown comes. But I question the entire premise because so many experts who missed it last time are once again selling fear. The contrarian in me thinks, ‘If all those guys are going left, then I’ll go right.” He identified trends that go against the fear of recession, including:

1. Fed Chairman Powell hinting at rate decreases.
2. No real leverage in the system, meaning debt is low.
3. Real talent and labor shortages, aka low supply = more demand.
4. Global large-scale capital is flooding to the U.S. for yield due to insane ZIRP [zero interest rate policies] by central banks around the world.

“I suggest you request written points on why the ‘experts’ are predicting a recession—other than an inverted yield curve—and it has been too long since the last recession. Ask them about how the entire central banking world is moving toward ‘Modern Monetary Theory,’ as the ‘Efficient Market Hypothesis’—the basis for business decisions since World War II—is becoming more outdated by the minute. I have a hunch this may not make it into the article.” (Editor’s note: Of course, this made it, John! We love contrarian views.)

**MARC ROUSSO**  
**JAYMARC HOMES, SEATTLE**

Marc Roussо and his partner Jay Mezistrano are two of the most interesting and passionate builders you’ll ever meet, in a truly unique market, Mercer Island and Bellevue, Wash. With zero vacant land, each lot is a tear-down, and base prices start at about $2.1 million, most selling for far more. The two former college DJs built a substantial company that got beat up at about $2.1 million, most selling for far more. The two former college DJs built a substantial company that got beat up zero vacant land, each lot is a tear-down, and base prices start at about $2.1 million, most selling for far more. The two former college DJs built a substantial company that got beat up. But they didn’t stop. Marc reports, “We faced a ‘slowdown’ here in Seattle from July [2018] to March of this year. During that time, each of the 10 moves below came into play. As is our policy, we had 1½ years of overhead in the bank, and we needed 50% of it to weather the slowdown, paying for overhead and extra expenses the lenders required from us.”

1. Reduce cost of overhead and “B” players now. Keep the best of the best on the team. The rest will understand. JayMarc let
three people go in October and has only added one part-time person since.

2. Purchase land that has a quick turn, preferably finished lots on take-down schedules.

3. Start negotiating with multiple vendors and suppliers ahead of a downturn. JayMarc actively sought out other vendors to bid against the old guard and it proved very beneficial.

4. Value-engineer plans by working with vendors and suppliers. The builder is doing this with all of its new plans this year and it is helping immensely.

5. Monitor, then eliminate variance purchase orders by adding them into scopes of work.

6. Reduce cycle time in buying, permitting, building, and selling the home. Create a better even flow and Lean manufacturing program. "We all went to Lean/Kaizen training and made it a part of our values," Marc says.

7. Build a bucket of cash, at least one year of overhead, not used for acquisitions.

8. Create a pool of investors that can jump on opportunities when the downturn arrives.

9. Take care of your team members by being honest and transparent with where things are in the business and the market.

10. Follow the Great Game of Business by Jack Stack. "We always have done this," Marc says. "Everyone loves the transparency."

BILL SAINT
CLASSICA HOMES, CHARLOTTE, N.C.

Bill Saint was president and CFO at Simonini Builders when it received the National Housing Quality Gold Award in 2001 and led his own company, Classica Homes, to NHQ Gold two years ago. If you seek great product coming from an exceptional culture, visit Classica.

Bill says the best defense is a good offense: "I say, after going through the last downturn, defense sucks. It’s no fun. It’s demoralizing. I will retire if I have to play defense to survive. Might as well watch bowling—just as boring! Offense is about sales. Offense is about inspiring customers to buy when the world says no. Offense is about keeping your team engaged to grow, think, work hard, sweat, and create the remarkable. I say, offense!"

MARK ADLER
MARK ADLER HOMES, WEST BLOOMFIELD, MICH.

When I launched TrueNorth 22 years ago, Mark was one of my first two clients, and he has experienced it all, doing whatever it took to get through the last housing crash and emerging with a new company and a different approach.

Mark puts it in plain language, with a touch of humor—something we’ll need as we march on toward this downturn, which may or may not be just over the horizon: "I see a slowdown, not a crash," he says. "I just plan on staying a bit aggressive, but not crazy. I see the young guys with no battle scars going crazy and I wonder about their fate."

He adds: "Don’t sign personally. If you absolutely must sign personally, then DO NOT HAVE YOUR WIFE SIGN! One thing you can count on when it comes to builders and developers is that we are the ultimate optimists. An old-timer—even older than me—told me: ‘When a steamroller runs over a builder/developer, all that’s left is a Rolex watch and two brass balls.’ For me, I never have—nor will I—own a Rolex watch."

SCRATCHING THE SURFACE

This is a good start, but there’s much more to consider. George Casey, another industry legend and the CEO of real estate consulting firm Stockbridge Associates, sent me a slide presentation he put together after the last housing recession. The presentation is so rich in content that summing it up would take an entire column, so stay tuned for that.

Meanwhile, the one thing we’d like to avoid is the self-fulfilling prophecy. If we expect a slowdown, will we hasten its arrival? If we aggressively plan for it, will we make it worse? There is an entire field called “behavioral economics” that deals with psychological and sociological impacts on economies, and my review of some of the literature makes it perfectly clear: Sometimes expectations move markets, sometimes they don’t. That’s not much help.

Some may say we shouldn’t even raise the issue, just keep on keepin’ on. But to adapt some phrasing from Neil Young: ‘I’ve seen the recession and the damage done.’ It was horrific. Half of U.S. builders—and an even greater percentage of the trades—went under.

I challenge you to find any builder who will say we couldn’t have been better prepared. So, we’d best heed the words of the survivors. Almost no one believes the next slowdown will be as bad as the previous one a decade ago. Yet if it’s just half as bad, even one-third as bad, we’ll all have our work cut out for us to remain within the ranks of the survivors. Time to get started.
Whenever I see George Casey’s name pop up, Johnny Cash’s classic country hit “I’ve Been Everywhere” comes to mind. Of the 90-plus cities and states named in that tune, it seems like half of them appear in George’s resume, as detailed on his LinkedIn profile. I don’t know anyone in the industry who’s had more substantive positions with more builders in more locations than George Casey, including senior roles with Toll Brothers, Realen, Zaring, and The St. Joe Companies. He’s also served as a board member for many firms, both private and philanthropic. He’s more than earned his chops.

Fifteen years ago, George rolled up all that experience into Stockbridge Associates, a well-respected real estate consultancy. He has suspended his operations there several times to accept longer-term assignments as a senior leader for companies undergoing major change requiring full-time attention.

My July 2019 column, “The Next Housing Downturn—Is It Too Late to Get Ready?,” reviewed the results of Zillow’s two most recent annual surveys of 100 real estate and home building experts, which both predicted a housing industry slowdown of some significance for Q1 2020. My column focused on three specific things the best builders are doing to improve margins today and prepare for the possible downturn, namely, reducing variance, simplifying product and process, and decreasing cycle time. Then, I asked builders who survived the last crash what they recommend today and combined their input for my September column, “Survivor! Home Building Edition.” Among the responses I received, George Casey’s was so comprehensive and thought-provoking that I decided to feature it for this month’s column in its entirety. As is his always-learning nature, George offered this outline on what he learned from the last recession, with an appeal to others to further develop his prescription for tougher times. So for those of you wondering “WWGD?” (What Would George Do?), here’s your answer.

LESSONS LEARNED FROM A DOWNTURN

CAN THEY HELP US NEXT TIME?

1 LITTLE THINGS HELP. George listed this one first, and there’s a message in that. When I look back over my own 30 years working with countless home building executives, the best ones instinctively pay attention to the so-called little things that keep spirits up, even in down times, while the worst don’t give them a thought. What are the little things that employees appreciate? You can probably think of a few, but the best source is to ask those you trust, at all levels in the company. Some suggestions may leave you shaking your head, but do them anyway. I’ve always been amazed how excited Texans get over a few boxes of tacos from Taco Cabana (get the brisket, trust me, get the brisket!), and I once saw a mob of freezing people in Boise lined up for a fleet of Friday food trucks, smiling all the while. Here are four little things that George employs:
FIND REALITY AND DEAL WITH IT. I worked for an executive years ago who frequently used the phrase “On a need-to-know basis!” Conservatively, three or four times as many people needed to know than he believed, and there was no end to the confusion that resulted. Another senior manager in the same company observed, “In the absence of information, people make up their own.” That’s exactly what they did, and it wasn’t pretty. Here’s George’s advice:
- Communicate reality to employees (brown bag lunch)
- Let banks know your strategy, frequently and in writing
- Figure out your “elephants” and micromanage them
- Hard “in your face” reality is better than rumor any day; most employees probably know the truth anyway

CASH IS KING. If you’re thinking this point rates as a big “Duh!,” there were literally hordes of builders, suppliers, and trade contractors who violated this basic principle in preparation for the last slowdown and paid the ultimate price. And as we learned from JayMarc Homes in my September column, that cash should also include provisions for keeping your staff going as long as possible; otherwise, you’ll start the next recovery in a hole. George recommends:
- Manage cash two to three times per week
- Learn to be more inclusive in cash projections; express them in different and better viewpoints
- Share the pain with vendors sooner than later
- Always keep a cash reserve
- Cut spending fast
- Institute tighter controls

FOCUS ON SALES MANAGEMENT AND VALUE ENHANCEMENT. No one expects the next downturn to be anything like the last big crash. With all the unfulfilled demand out there, we could drop 20% or more and still sell a million units. To follow the advice of “the best defense is a good offense!” from Bill Saint of Classica Homes, your sales team has to be top drawer in every way. George’s observations include:
- “Shy salespeople have skinny kids”
- “Today could be the last day to sell a home” mentality
- Stage completed inventory homes
- Add big landscape enhancements; front and rear yards
- Value-enhance rather than cut price
- Measure conversion rates
- Work the 7 Ps (product, price, place, promotion, people, process, presentation)

KNOW YOUR NUMBERS. I’m a bit of a numbers freak. I not only enjoyed statistics in college, I took stat courses beyond the requirements. To most of you, that’s just weird, but I have written more columns on measuring and “counting” than I can remember—because in general we aren’t that great at it. George’s final point below, breakeven, was of major emphasis in my July column. Adding to his list, I’d also highly recommend an even stronger focus on key process measures, such as new community start-up, cycle times of every phase of the business, and variance levels.
- P&L
- Cash
- Market comps
- Gross and net margins by house
- Starts
- Spec limits (internal and bank)
- Breakeven (cash and income statement)

FIND OUT WHO YOU WANT IN THE FOXHOLE WITH YOU. A downturn can be very much like a war, with builders competing for scarce resources (buyers), everyone taking shots at you, and having to track, measure, and manage all the variables that can make or break the company. It’s not life and death, but it feels like it sometimes. So, take a moment, think ahead, and ask the tough question: If push came to shove—a slowdown became a genuine downturn—who would you absolutely, positively want there with you as you fight the good fight? Identify those folks now and make sure they understand their value and your commitment to them. That will earn their commitment to you. George advises:
- Experience helps
- Value flexibility and the willingness to take on new assignments
- Performance matters, not just talking about it

HAVE A BIAS TOWARD ACTION. So many builders and individuals fall victim to inertia, working the same habits, systems, and processes. I’ve experienced this myself, occasionally suffering from “analysis paralysis,” and it can be hard to break through to a new plan. The admonition to “Don’t just stand there, do something!” always feels good to say, yet it has led to some massive errors in judgment. You’ll also hear, “Don’t do something, just stand there!” as a warning to consider very carefully before charging off in a new direction. There are mines buried out there, but George challenges you to:
- Change the organization
- Find value enhancements
- Establish realistic pricing
- Don’t hesitate to make needed cuts
**8 STRONG PROCESSES WIN OUT.** With each new year comes another study describing home building's dismal failure to keep pace with the massive productivity gains found by most industries since the end of WWII. That failure is all tied up in antiquated and ineffective processes. Almost daily we read a new article, blog, or social media post extolling the miracle promise of off-site home construction.

We will (and absolutely have to) move in that direction, but let's not forget that at least 25% of the average new-home sales price is tied up in process waste. After more than 200 lean process implementations, we have the data to prove it, and George agrees. There is so much we can do now to boost margins, secure the trade base, increase the sanity level in our staff, and improve quality before the perfect off-site outfit comes to town.

Pursue process maniacally across the board, and George's list here is a good starting point:

• Review your purchasing processes
• Renegotiate everything
• Prioritize cycle time control and improvement
• Control your starts
• Check market comps frequently
• Review and streamline IT applications

**9 DON'T BE AFRAID TO CHANGE THE ORGANIZATION.** The organizational structure that worked for you in strong times may look quite different than the one that works in a downturn. Do you still have, as Jim Collins described in his seminal work “Good to Great,” the right people on the bus and in the right seats? The key message from George’s list below is to reexamine exactly how your company needs to operate in your current environment, then organize your company around that in a very intentional way.

• Reset local project management structure
• Eliminate divisional structure
• Organizations do the things they’re organized to do; find the bottleneck or opportunity and organize around it
• Focus on cycle time
• Close out jobs in process
• Eliminate sitting inventory

**10 YOU CAN'T CUT TOO DEEP TOO FAST.** This one makes me nervous. What happened from 2008 to 2012 was not a downturn, it was an all-out crash. As I said above, at this point no industry experts or economists are forecasting a repeat of that debacle. It’s true that most builders woke up one morning in 2010 thinking, “I was too slow to cut and should have gone deeper.” My concern is the consequences of overreacting during a nominal slowdown or even a more significant downturn, but still short of a crash. How many good people who spent years learning your systems, processes, and products will you lose? Maybe it’s as simple as how deep your pockets are and how well you have prepared. That said, George has far more experience managing through downturns than I, so when your reading of the economic tea leaves triggers the warning light, heed his advice to cut deep and fast in:

• Land
• People
• Spending
• Production

Hard decisions have to be made; sometimes they’re personal.

George Casey is back to running Stockbridge Associates these days. He also chairs the Housing Innovation Alliance, a coalition of forward-thinking builders and product suppliers that has become one of the leading voices on innovation of all types in home building. Their in-person and online events are excellent, and I suggest you check them out at housinginnovationalliance.com. My sincere thanks to George for sharing his experience and wisdom for this column.

I also have an exercise for you and your team that I guarantee will yield results now and could be a major factor in how well you prosper in the next downturn. Email info@truen.com and request a PDF of my three-column series “Preparing for the Downturn,” which includes this article along with the July and September columns.

And, if you enter “Downturn Prep” in the subject window, I’ll also send you step-by-step instructions on how to use the materials with your team to get them involved now in preparation. If the Zillow group of 100 experts is right and a slowdown of some significance begins in Q1 2020, you have no time to lose. **PB**

Scott Sedam is president of TrueNorth Development, a consulting and training firm that works with builders to improve product, process, and profits. For a free PDF of “Preparing for the Downturn,” email your request with contact information to info@truen.com. You may reach Scott at scott@truen.com or 248.446.1275.