

image



Berkshire Hathaway's \$6.8 billion acquisition of Taylor Morrison in one in a string of similar deals this year.
DAVID PAUL MORRIS/ BLOOMBERG NEWS

U.S. Housing Flashes Opportunity

Berkshire Hathaway and Japanese builders agree stocks look cheap and there is a need for innovation in residential construction

What does **Berkshire Hathaway** see in America's home builders that investors in public markets have missed? Maybe the same thing as Japanese firms eyeing the industry: a chance to boost innovation in one of the least productive parts of the U.S. economy.

America's listed home builders are proving popular with patient investors looking for opportunities beyond the AI trade. Berkshire Hathaway's \$6.8 billion acquisition of Taylor Morrison is the latest in a string of similar deals this year.

In February, Sumitomo Forestry said it was buying Tri Pointe Homes for \$4.5 billion. The deal makes the Japanese builder the sixth-largest home builder in America. In March, Trumark Cos., a U.S. subsidiary of Japanese construction firm **Daiwa House**, bought JK Monarch. Stanley Martin Homes, which is also owned by Daiwa House, said it would buy United Homes Group in a \$221 million deal.

That's not all. An affiliate of Japan's **Iida Group Holdings** bought a majority stake in Utah-based Wright Homes in March. In all, Japanese home builders are set to control 6% of U.S. singlefamily housing construction.

America's home-building industry is very fragmented. Based on the number of home sales they close annually, the top two players, D.R. Horton and Lennar, have a roughly 14% share of new single-family home sales each.

Note

But a lot of housing is built by much smaller players that don't have the means to spend on research and development. There are tens of thousands of residential builders in America, and the annual median number of new housing starts among members of the National Association of Homebuilders is six. - Note

The incentive to bulk up in today's tough housing market is high. Builders have to offer sweeteners like mortgage-rate buydowns to get reluctant buyers to commit. Profit margins are being squeezed across the industry as a result. The more that builders can offset the hit by reducing the cost of their supplies, or land purchases, the better. Bulking up is one way to do this. - Note

Innovation in building techniques might be the next lever they can pull. According to UBS housing analyst John Lovallo, 15% of homes in Japan are built using modular construction, where parts of the home such as the walls are made in a factory and transported to a building site, where they are assembled into a new home.

More widespread adoption of modular construction, which is used in only 3% of new U.S. homes today, could be a way to protect profit margins, or make homes more affordable for buyers. A UBS study found that switching from traditional stick-built walls to modular open wall panels can cut waste by 20% and could increase operating profit by \$6,175 per home.

Berkshire Hathaway is already familiar with the technology. Clayton Homes, which it bought more than two decades ago, is a top builder of manufactured housing and modular homes.

American homes are still largely built the same way they were a century ago. Most of the machinery used in construction was invented decades ago: bulldozers in the 1920s and cranes in the 1940s, Goldman Sachs notes.

This may explain why labor productivity in the construction industry fell 30% between 1970 and 2024, while productivity more than doubled in the wider economy. Factors outside the industry's control, like land-use restrictions, are responsible for 40% of the productivity gap, Goldman Sachs estimates. But a lack of innovation explains one-fifth. - Note

Taylor Morrison's market valuation was likely a big attraction for Berkshire Hathaway. The company's stock was trading around 10 times projected earnings right before the deal announcement, which looks cheap relative to the S&P 500's multiple of 21 times.

The acquisition may also be a sign that Berkshire thinks the worst will soon be over for America's home builders, which are currently struggling to clear unsold inventory.

The Iran war may slow the recovery. Mortgage rates are rising again as inflation fears push up 10-year Treasury yields, which are the primary benchmark for 30-year home loans. But demand should return eventually, considering the U.S. housing market is so undersupplied. When it does, more efficient players will be positioned to take share.

A deep-pocketed investor like Berkshire Hathaway can ride out the slump. In the meantime, there is an opportunity to boost profits by doing things differently on construction lots.

—
Carol Ryan

The following is a digital replica of content from the print newspaper and is intended for the personal use of our members. For commercial reproduction or distribution of Dow Jones printed content, contact: Dow Jones Reprints & Licensing at (800) 843-0008 or visit djreprints.com.
