

**LENNAR CORP**

**Moderator: Grace Santaella**  
**March 21, 2017**  
**11:00 am EST**

Coordinator: Welcome to Lennar's First Quarter Earners conference call. At this time all participants are in a listen-only mode. After the presentation we will conduct a question and answer session.

Today's conference is being recorded. If you have any objections you may disconnect at this time. I will now turn the call over to David Collins for the reading of the forward-looking statements.

David Collins: Thank you and good morning everyone. Today's conference call may include forward-looking statements including statements regarding Lennar's business, financial condition, results of operations, cash flows, strategies and prospects.

Forward-looking statements represent only Lennar's estimates on the date of this conference call and are not intended to give any assurance as to actual future results.

Because forward-looking statements relate to matters that have not yet occurred these statements are inherently subject to risks and uncertainties.

Many factors could affect future results and may cause Lennar's actual activities or results to differ materially from the activities and results anticipated in forward-looking statements.

These factors include those described in this morning's press release and our SEC filings including those under the caption risk factors contained in Lennar's annual report on Form 10K most recently filed with the SEC. Please note that Lennar assumes no obligation to update any forward-looking statements.

Coordinator: I would like to turn – I would like to introduce your host, Mr. Stuart Miller CEO. Sir, you may begin.

Stuart Miller: Great, thank you and thanks David. This morning I am out west with Rick Beckwitt, our President, Jon Jaffe, our Chief Operating Officer and Eric Feder from our Rialto Group.

We are going to begin our Trade Partner Summit later tonight. That is why we are out here and this is where we invite many of our manufacturers, suppliers and distributors to discuss the homebuilding landscape and to consider better ways to partner and to keep cost and profitability property – properly aligned.

On the call from Miami we have Bruce Gross, our Chief Financial Officer, Diane Bessette, our Vice President and Treasurer and of course David Collins, our Controller who delivered our forward looking statement and we also have Jeff Krasnoff, CEO of Rialto.

I want to apologize in advance if there are – if we are a little disjointed as we are going to attempt to coordinate from different locations.

As always I am going to start with a brief overview and Bruce will deliver further detail in guidance. As always after our prepared overview we will open to Q&A and I would like to request again that you limit your time to one question, one follow-up so we can enable as many participants as possible within the hour that we have allotted.

So let me go ahead and begin and start by saying that market conditions certainly feel like they are strong and strengthening. The slow and steady though sometimes erratic market improvement that we have seen for the entirety of this recovery seems to be giving way to a more definitive reversion to normal.

While our first quarter operating results, particularly gross margins reflect some of the sluggishness seen at the end of last year, our sales results went from tepid, to better, to strong as the quarter progressed.

Limited supply and production deficits are now intersecting with land and labor shortage and this suggests, though not yet seen but suggests that pricing power is on the horizon as we move through the year.

So what are the factors that are driving the change in market sentiment and conditions? They are certainly not apparent if you listen to the news stations. As our traffic has increased we are getting some very direct feedback from our customers as they tell us what they are looking for, their timing and sometimes their motivation.

There is clearly a sense of general optimism in the market. There is a perception that jobs are being created and that wages are actually starting to move upward. There is a solidifying sense that the government has adopted a

business friendly posture and that will result in real changes to tax rates and to the regulatory environment.

The banking world is making more overtures to small businesses and to mortgage borrowers and there is a sense that borrowers can make their way through the process.

Additionally, the upward direction of interest rates has encouraged some to get off the fence and consider purchasing a home rather than renting.

Rents have risen and the prospect of higher purchase prices and higher interest rates makes a compelling case that today's opportunity might be the best opportunity to leave those annual increases in monthly payments behind.

Although there is also a lot of negative noise at the same time it seems so far that the market is looking through the noise and is injecting optimism about the future in its purchase consideration.

Additionally, the economic realities of a constrained supply of housing options and the economic realities of rental rates are beginning to have a rational impact on decision making for the first time buyer as millennials are coming to market.

Interestingly the front page of USA Today reports today that 60% of millennials ages 18 to 35 are living with parents, relatives and roommates and that is a 115-year high.

Across our platform each of our business segments benefits from the improvement in the market. As we look ahead to the remainder of 2017 we are expecting that each of our business segments will continue to grow, to

mature, and to improve and will exceed expectations, particularly in the back half of the year.

Although our first quarter earnings were lower compared to the first quarter of 2016 that is primarily due to a higher tax rate, some one-time WCI closing costs and a fully expected decline in gross margin – while some of the same pressures will exist in the second quarter as well the acceleration in sales pace against the limited supply and constrained capacity for the market to quickly increase production portends pricing power and a very strong second half of the year.

Against that backdrop let me briefly discuss each of our operating business segments. Our for sale core homebuilding operations are extremely well positioned for a very strong 2017.

Our sales were up 11% year-over-year before WCI, 12% including WCI, driven by our strategy of driving better quality traffic through our digital marketing efforts.

Interestingly our internet leads were up 18% year-over-year to about 100,000 for the quarter. Our social media followers were up 17% year-over-year to 2.8 million on an annual basis and YouTube views were up by 10 million for the year.

Fueled by our digital marketing efforts and other initiatives as well we continue to focus on operational efficiency as our SG&A is at a historic low for our first quarter.

Again interestingly, our marketing and advertising spend is now down year-over-year for nine consecutive quarters. We continue to operate at a very high level of efficiency and we are improving.

And while we match production with sales pace we continue to maximize our gross and net margin at 21.1% and 10.8% respectively as we maintain higher sales price in order to maximize returns on our valuable land assets and we manage costs by striving to be the builder of choice to the trades in each of our markets. Our Trade Partners Summit that I mentioned earlier is a big part of that effort.

Though some might be concerned by our lower gross margin we are exactly where we expected to be in the first part of this year and our year end margin will still be right on top of our guidance.

Of course we closed on the WCI acquisition in the first quarter and that transaction is going very well, is being guided by Rick Beckwitt and his team led by Fred Rothman and Derick – Darin McMurray and I have asked Rick to speak specifically to this transaction so let me turn it over briefly to Rick.

Rick Beckwitt: Thanks Stuart. On February 10, 2017 Lennar closed on the acquisition of WCI Communities that was previously announced in September of 2016. The purchase price for WCI totaled approximately \$643 million which we funded with cash and we also assumed \$250 million in senior notes.

The transaction combined two of the largest homebuilders in Florida and significantly expands Lennar's product offerings to include luxury, single family and multi-family homes.

WCI's focus on amenity rich, lifestyle, master plan communities catering to the move-up, active adult, and second home buyers truly complements Lennar's leading market position in the entry level and move-up markets in Florida.

During our extensive due-diligence period we identified five main drivers of value creation and synergies. I will go through each of these drivers in a second but I am happy to say that the WCI integration has gone very smoothly and that we are ahead of schedule which will lead to a timely realization of this value creation for our shareholders.

The first driver was WCI's portfolio of low cost land located in most of the highest growth and largest Florida coastal markets. We acquired over 13,500 home sites adding 51 actively selling communities and an additional pipeline of future community openings for the next several years.

This land portfolio will produce strong gross margins going forward. The portfolio included many large, amenity rich, "A+" master plan communities that would be impossible to purchase in today's land constrained market.

We have great confidence that we will produce extremely strong returns from these assets as they will be managed by some of the best performing and most profitable divisions in our company.

When we close the acquisitions we acquired 361 homes in backlog with an average sales price of \$516,000 totaling \$188 million in near term revenue and cash flow. In addition at the end of the first quarter we had 942 WCI homes in various stages of construction.

The second driver was the value maximization of the communities through the reallocation of the WCI and Lennar product and branding. During the due diligence period we analyzed each community to determine whether we would make higher returns and profits by building WCI product or Lennar product.

Approximately one third of the communities that we acquired will be converted to the Lennar brand. In these communities Lennar has product that is very similar to WCI and by converting these communities to the Lennar brand we will significantly lower our build cost with very little, if any impact on the sales price of the home.

We will also significantly increase sales pace and reduce cycle times. These changes will increase both profitability and IRR. We have also identified several Lennar communities that we will be building WCI product. In these communities we will be able to achieve much higher sales prices with the WCI brand.

We are also planning to build both WCI and Lennar brands in some of our larger communities that benefit from a dual marketing strategy. This will allow us to increase absorptions and maximize the value of our underlying land positions. This is something we have done very successfully with a higher price Village Builders brand in Texas.

The third driver is utilizing our efficient homebuilding operating platform and leveraging our purchasing power. Included in this is streamlining WCI's approach to options but we will still offer WCI home buyers a selection of high quality options and upgrades, we will be restructuring their design studio to include a more streamline selection of options and upgrades.



This is similar to what we do in Texas and has allowed us to offer options and upgrades with a more cost effective G&A structure.

Given our leading national and Florida positions Lennar can purchase materials and labor at a much lower price than WCI. This will not only lower build costs but provide greater value to the WCI home buyers. Cost savings will also flow from reduced cycle time.

We have been working with our trade partners to rebid the WCI floor plans and make them more efficient to build. We expect to have this completed by the end of our second quarter, however, you will not see the full benefits at lower cost per square foot until 2018, once all the acquired inventory and homes under construction are delivered.

Based on our due diligence and work to date we expect to save between \$8 to \$12 per square foot or 200 to 300 basis points on new starts once the rebidding process is completed.

And finally, given the strides we have made in digital marketing we expect lower sales and marketing costs associated with these WCI communities as well.

The fourth driver was the synergies associated with lowering G&A costs. These include the elimination of costs associated with running two public companies as well as headcount reductions associated with overlapping corporate and operating functions.

While there may be some – while there will be some upfront costs associated with implementing these changes we anticipate annualized savings of approximately \$30 million beginning in late 2017.

I am sad to say that Keith Bass, the CEO of WCI will not be moving forward with Lennar. While I have hoped that Keith would join us and be a big part of our growth going forward he has chosen to take some time off and explore some other opportunities. We wish Keith great success going forward and thank him and the entire WCI team for building such an incredible company.

Finally, the last driver was capturing incremental profits through the rollout of our mortgage and title operations to WCI's homebuilding operation and its Berkshire Hathaway Home Services operation. This process has begun and we should see a meaningful pickup in activity in financial services as we move into 2018.

In conclusion, we are very excited about this acquisition and while we are focused on these five value creation ideas we are certain that we will find other areas that will benefit our shareholders. I will turn it back over to Stuart.

Stuart Miller: Great, thanks Rick. As you can see I think we have got our WCI transaction well in hand and we are very enthusiastic about it.

So to wrap up homebuilding I want to say we have noted before that our strategy remains a clear pivot in land strategy towards a shorter term land acquisition and towards a 7% to 10% growth strategy.

Given the WCI addition our 2017 growth rate should be on the higher side of our goals or a little over that goal. We have also refocused on expanding our first-time buyer offering with our mix now standing at right around 40%.

Combined these strategic elements will continue to produce very strong cash flow for the company and will result in continued balance sheet improvement.

Now I want to turn briefly to our other segments. As you have seen our financial services segment is also off to a great start in 2017. Of course the business is growing in lockstep with our homebuilding operations and will expand with the addition of the WCI acquisition but it is also expanding its non-Lennar business reach and growing bottom line.

Financial services results exceeded last year's first quarter result by 38% driven in part by increased profitability and title operations and Bruce who oversees this operation will give additional color in his portion.

Lennar multi-family. We couldn't be more pleased with the evolution and performance of LMC. Our entry into the apartment development business was timed perfectly and LMC continues to execute flawlessly.

LMC under the leadership of Todd Farrell has reached maturity and is poised for continuous annual profitability. As noted in our press release this segment generated \$19.2 million in pre-tax income, up 57% from last year as we sold another two communities under our Merchant Build Program.

During the first quarter we started some 1,373 apartments in five communities with a total development cost of approximately \$600 million. As of February 28, 2017 we had a geographically diverse pipeline of 74 communities totaling almost 23,000 apartment homes with a total development cost of almost \$8 billion.

We are gearing up our Build to Core Program that we have discussed in the past with some 20 communities for 6,000 apartments already under construction to fill the \$2.2 billion equity bucket with geographically

diversified “A” located, brand new and modern apartment communities in a generally shelter constrained environment.

Rialto also turned in an excellent quarter. Rialto contributed \$12 million to the bottom line in this quarter as market conditions favored this business segment as well. The various elements of Rialto are starting to take shape as we continue to work through the remaining legacy assets on book.

In this quarter we have started to book some of the long awaited promote from Fund I which reflects the work of the extraordinary team of professionals investing and managing third party capital and generating industry leading returns.

Additionally, market conditions particularly favored Rialto Mortgage Finance as that exceptionally run team which is focused on the commercial mortgage conduit business exceeded expectations and closed three transactions totaling \$478 million.

The intersection of an outstanding operating team and strong market conditions produced an industry leading net margin for the company.

Finally, FivePoint remains poised as a self-sufficient standalone large scale community builder in California. This company manages and controls some of the best positioned properties in some of the most land constrained markets in the country.

The current market optimism raises the possibility that this company that has been waiting for market conditions to reopen the IPO market might just find a window to go public. We will see if the current sweep of optimism in the capital and stock market sets the stage for FivePoint’s future.

So in conclusion across the platform of our company we are feeling pretty optimistic about this year ahead. We are clearly well positioned to capitalize across our platform on the strong market conditions that seem apparent.

Each of our operating segments is mature and positioned to perform in strengthening market conditions. People, assets and operations are all aligned to perform in 2017 and we look forward to keeping you updated.

With that let me turn it over to Bruce.

**Bruce Gross:** Thanks Stuart and good morning. Revenues from home sales increased 13% in the first quarter driven by a 13% increase in wholly owned deliveries and a consistent average selling price of \$365,000.

WCI had a minimal impact to revenues in the first quarter as there were only 51 deliveries from the acquisition date until the end of the quarter.

Our gross margin on home sales in the first quarter was 21.1% and as Stuart mentioned we are still on track with our previously stated gross margin goal of 22% to 22.5% for the full year.

The gross margin decline year-over-year was due primarily to increased land and construction costs. Our gross margin percentage was impacted 10 basis points due to the write up of WCI backlog inventory that closed during the first quarter.

Sales incentives were at 5.9% this quarter compared to 5.6% in the prior year but it improved sequentially from our fourth quarter total of 6.2%.

Gross margin percentages were once again highest in our home building east segment. Direct construction costs were up 4% year-over-year to approximately \$55 per square foot and that was driven by approximately a 6% increase in labor and 3% in material costs.

SG&A percentage – as a percent of home sale revenue in the first quarter was 10.3%. We are continuing to improve SG&A operating leverage by growing volume organically in our existing homebuilding divisions and benefiting from the focus on technology investments that Stuart mentioned.

Included in SG&A in the first quarter were one-time expenses related to the WCI acquisition mainly offset by one time legal and insurance benefits resulting in a net one time charge of approximately \$2.7 million or 10 basis points impact to SG&A percent during the quarter.

Other income was \$5.7 million compared to other expense of \$600,000 in the same period last year. Equity in loss from unconsolidated entities was \$11.5 million which included our share of net operating losses from JV's as they incurred G&A costs while ramping up for future land sales.

During the quarter we opened 58 new communities and added 51 net communities from the WCI acquisition to end the quarter with 752 net active communities.

New home orders increased 12% and new order dollar value increased 16% for the quarter. WCI had a minimal impact to this number as there were only 70 new home orders from this acquisition since we only had a couple of weeks in that first quarter post-acquisition.

Our sales pace was higher compared to the prior year at 3 sales per community per month versus 2.9 and that improved sequentially throughout the quarter. The cancellation rate was 16%.

In the first quarter we purchased approximately 8,300 home sites totaling \$659 million and just to note the first quarter usually has the largest dollar amount of land purchases for the year. Including the home sites from the WCI acquisition our home sites owned and controlled now total 173,000 home sites of which 137,000 are owned and 36,000 are controlled.

We now have approximately 4.6 years supply of land owned based on this years projected deliveries. We expect the year's supply of land to continue to decline as we continue with our soft pivot of land strategy.

Our completed unsold homes at the end of the quarter were in our normal range of one to two per community totaling 1,342 homes.

Turning to financial services this segment had strong results with operating earnings of \$20.7 million compared to \$14.9 million in the prior year. Mortgage pretax income increased slightly to \$13.4 million from \$13 million in the prior year.

The improved earnings were driven by higher volume. Mortgage originations increased to \$1.8 billion versus \$1.7 billion in the prior year and the capture rate of Lennar Home Buyers was 81% compared to 82% in the prior year.

Our title company's profit increased to \$6.8 million during the quarter from \$2 million in the prior year and this was driven by a 15% increase in revenue during the quarter and the associated overhead leverage from this higher volume.

Turning to the Rialto segment and providing some more details, the operating earnings were \$12 million compared to \$1.9 million in the prior year. Both amounts are net of non-controlling interest.

The investment management business contributed \$34.4 million of earnings primarily due to \$33.4 million of management fees and other and this included \$10 million of carried interest received in the quarter relating to Fund I.

At quarter end the undistributed hypothetical carried interest for Rialto Real Estate Funds I and II now totals approximately \$125 million. Rialto Mortgage Finance contributed \$478 million of commercial loans into three securitizations resulting in earnings of \$33.2 million compared to \$380 million and \$3.9 million in the prior year respectively and these are both before their G&A expenses.

The increase in earnings was primarily due to an increase in volume and average net margins of the securitizations from 1.6% in the prior year to 7.1% in the first quarter.

Our direct investments had a loss of \$15.9 million during the quarter as we continued to work towards monetizing the remaining assets purchased from early portfolios.

Rialto G&A and other expenses were \$33.3 million for the quarter and interest expense excluding warehouse lines was \$6.4 million. Rialto ended the quarter with a strong liquidity position with \$163 million of cash.

Turning to the multi-family segment I will just add a couple of comments to what Stuart mentioned. The \$19.2 million of operating profit in the quarter



was driven by the segment's \$26 million share of gains from the sale of two operating properties, as well as management fee income partially offset by G&A expenses.

Our tax rate for the quarter was 34%. The rate is higher than the prior year's rate of 28.1% because the prior year had one-time adjustments due to an IRS settlement and energy credits. We expect the tax rate to be 34% approximately for the remainder of 2017.

Turning to the balance sheet which remains strong we had a net debt to total capital of 41.6% which was an improvement of 370 basis points over the prior year. Our liquidity strength provides exceptional financial flexibility with over \$640 million of cash and only \$250 million of borrowings on our \$1.5 billion committed revolving credit facility.

Additionally we grew stockholder's equity by 24% year-over-year to \$7.2 billion and our book value per share grew to \$30.70 per share.

The preliminary goodwill estimate from the WCI acquisition is \$150 million to \$175 million and that is subject to revision as it is still being reviewed both internally and externally.

During the quarter we issued \$600 million of 4 1/8 senior notes due 2022 and we added \$250 million of 6 7/8 senior notes due 2021 as part of the WCI acquisition which we are likely to refinance at the next call date in August.

Finally, I would like to update our goals for 2017. Some of you already included WCI in your estimates for 2017 and all of the numbers that I will be providing here include the full impact of the WCI acquisition which will be accretive in 2017.

Starting with deliveries we are increasing our delivery goal to between 29,500 and 30,000 homes for 2017. We expect the backlog conversion ratio to be approximately 75% to 80% for the second quarter, 75% to 80% for the third quarter, and over 90% for the fourth quarter.

We are still expecting an average sales price between \$365,000 and \$370,000 for the full year and we are right on track with our operating margins of around 13% for the full year.

There will be an impact to our second quarter gross margin from writing up WCI's backlog and purchase accounting. As a result we expect our second quarter gross margin percentage to be between 21% and 21.5% while the full year gross margin is still expected as I mentioned to be 22% to 22.5%.

We still expect continuing improvement in the SG&A line from operating leverage and our investments in technology, reducing SG&A to between 9.1% to 9.3% for the full year – the second quarter we will have some nonrecurring transition costs relating to the WCI integration, therefore we expect SG&A to be approximately 9.5% in Q2.

The operating leverage will be in the second half of the year to match up with our highest volume quarters.

Financial services we are increasing the goal to approximately \$160 million for the year with the second quarter expected to be approximately \$40 million. The increase is due to the partial year inclusion of the Berkshire Hathaway Realty Services brokerage operation from the WCI acquisition, as well as additional closings from the WCI deal.

We are adding WCI to our mortgage platform, although keep in mind 50% of the WCI buyers use all cash and we will focus on capturing a high percentage of the other 50% that require a mortgage.

Rialto is still expected to generate a range of profits between \$45 million and \$55 million for the year with the second quarter expected to be approximately \$5 million.

Multi-family is still expected to be between \$70 million and \$80 million for the full year. The second quarter is expected to be also approximately \$5 million which includes one apartment community sale.

The category of joint ventures, land sales and other income is still expected to be in a range of \$70 million to \$80 million of profit for the year, however, the second quarter is expected to have net expenses of \$15 million to \$20 million while the second half of 2017 is driving all the profit for this category.

Corporate G&A is still expected to be 2.2% to 2.3% and our net community count is expected to end the year between 770 and 780 communities.

And last our balance sheet we still continue to expect a similar level of operating cash flow in 2017 as we accomplished in the prior year.

With these updated goals in mind we are well positioned for the remainder of 2017 and with that let me turn it back to the operator to open up for questions.

Coordinator: Thank you. We will now begin the question and answer session. If you would like to ask a question please press star followed by the number one and record your first and your last name clearly when prompted.

Your name is required to introduce your question. To cancel your question please press star followed by the number two - one moment please for the first question. Our first question comes from Carl Reichardt from BTIG. Your line is now open.

Carl Reichardt: Good morning everybody. Stuart I wanted to ask about your comment related to pricing power. First of all does the overall guidance for the year assume that you will be able to push those prices? Is that largely on the low end where you think you might be able to do that?

And in the context of the potential for higher rates, flattening rents, you know, certainly plenty of competition from peers. What gives you confidence that you may have that ability?

Stuart Miller: Interesting Carl we – our guidance is really tied to the current state, the current market environment, the way that we see things right now. The discussion, the statements that I made on the conference – on the – my prepared comments and in our quote really are kind of forward looking giving – given the temperament of the market right now and kind of what we see around the corner or what we feel like we are seeing around the corner.

You know, I don't want to get out – too far out over our skis. We are not injecting that optimism in our guidance right now but what we are seeing and what we have heard a lot about is supply constraint across all kinds of – all dwelling product types from rental to for sale and we have also seen that we are land constrained and production constrained and that has been the case for some time.

The injection of some market optimism and what we saw in our sales pace as we went through the quarter really gives me reason to believe that as we look

out ahead a couple of quarters we are going to start to see prices move just as we would expect with a demand and supply imbalance with demand increasing and supply somewhat constrained. So that is kind of where we are on that.

Our guidance was really rooted in where we have seen things on a more current basis.

Carl Reichardt: Okay thanks Stuart. And my follow up is you made a comment about banks making more overtures to borrowers and I wonder if you could flush that out in terms of mortgage lending particularly to first time customers and then also in terms of community banks or I guess even money center banks financing developers and the potential that you could start to see some more opportunities to option finished lots since that has been, you know, something that has been lacking for a while? Thanks Stuart.

Stuart Miller: Yes, sure - so my comments about banks is more narrative that we are hearing from the banks than actual action in the field at this point. The banks are definitely starting to talk about the regulatory environment shifting and the enforcement environment shifting and reverting to a more normal state.

The banks are starting to talk about their ability to think about getting back into the mortgage market and lending to smaller businesses which I think is sorely needed and these things will all ripple through the housing market in a positive way.

Let's go on to the next question.

Coordinator: Our next question comes from Alan Ratner. Your line is now open.

Alan Ratner: Hi guys, good morning nice quarter. My questions relate to the cost side and Stuart maybe since you are on the verge of meeting with a bunch of your trades hopefully, you know, you will get some more insights here but, you know, if you look at in California there has been some pretty wet weather there and I know there is some concern that we might see something similar to what happened in 2015 as an industry when I think Texas in particular felt some pretty significant headwinds from a wet spring and as the year went on I think a lot of builders struggled to get homes closed and costs went up and you guys obviously navigated that very well but it certainly does create risk from the industry is concerned as far as cost going up.

So A), I am curious, you know, what you are hearing there as far as the – just general availability of labor and the industry's ability to deal with some of those weather headwinds and my second question on California specifically there is some news about a proposed bill out there that would potentially raise construction cost quite a bit, you know, with the prevailing wage requirement in communities there.

So was curious if you looked at that at all – what impact that might have given your pretty significant land position in California and, you know - how you would handicap the likelihood of that passing at this point? Thank you.

Stuart Miller: Okay, so wow that is a real fistful of questions. Let's start with the California question and let's remember that there are always legislative moves afoot to alter the landscape in California.

The legislation that is proposed at this point is just another one of those that comes down the pipe on a pretty regular basis and, you know, we will just have to see where it works out. It is a bill that is implemented as it is described would have an impact on costs relative to residential construction.

Some communities out there including some of our larger scale communities in Five Point might be exempt from the legislation so it would be a mixed bag of impacts, some of them positive, some of them negative. I think overall negative for affordability in California and so this is going to be, you know, talked through and worked out and see where we actually end up but this is the landscape in California and I think that all of these type of legislative initiatives come with positive and negative impacts and we will just have to see where this one shakes out.

As it relates to construction costs overall the story around construction costs has been one of increases over the past many quarters. You have heard us talk about that. I think that as we think about our numbers construction costs as a percentage of our sales price has probably moved up around 100 basis points and there is most certainly pressure on construction costs in a labor constrained market and this is why we focus on our Trade Partner Summit, our relationship with our trade partners making sure that we are the builder of choice for our trade partners. We think that this is a strategic advantage for the company and we spent a lot of time developing relationships throughout our trades.

So let me just turn it over to Jon and ask him because Jon really spearheads this effort within the company and has done a remarkable job.

Jon Jaffe: Hi Alan, so clearly the pressures remain from a labor constrained market. What we see a little bit different is we have seen some pressure on the materials side. Lumber for example is up about, you know, 9% since December and we have seen an impact there.

And you look at all the commodities they all have moved up in part in reaction to expected expenditures by the government with infrastructure and that is effecting the supply chain but as Stuart mentioned our focus is – those cost prices are going to be what they are and positioned ourselves to how we take advantage of the marketplace of whatever landscape is in front of us and I think that actually communication and relationships with our trades to make sure we are well positioned.

There will be a spike of activity once the weather dries up in California as you note and we have – we are in deep discussions with all the trades about how to manage that as that comes out and I think we will navigate those waters very well.

Alan Ratner: Great, thanks again guys. Good luck.

Stuart Miller: Thank you. Next question.

Coordinator: Our next question comes from Stephen Kim from Evercore ISI. Your line is now open.

Stephen Kim: Yes thanks very much guys. Congrats also in a good quarter. Stuart I wanted to ask or maybe Rick could also chime in here. I guess on the community count guide – a little lower than what we had been thinking initially and I guess obviously demand has been better than expected – than we might have thought and – so we are trying to figure out whether or not this means that you are going to be selling out of communities a little quicker or if it means on the other hand that in response to the strong demand you are going to actually open up more communities to the greatest of your ability and so how that all nets out.



We are curious as to whether or not you think that you are going to be able to accelerate community openings as you get maybe into the back half a little bit more than what you – than what your guidance would seem to suggest or are you just being conservative in that regard?

Or do you think because of demand is going to be good you are just going to sell out of stuff a little quicker and so maybe it is not until 2018 that we see an improvement in, you know, an additional step up in community count.

Rick Beckwitt: Well Steve this is Rick. I think you have really nailed it. It is a combination of some acceleration of absorptions in some really well located communities. That combined with some weather impacts that have delayed some of our communities opening.

And there is also a portion of it where we buy home sites from third party developers and we can't control the schedule that they deliver the home sites to us.

I think as we approach the back half of the year you will start to see an acceleration of community count and clearly into 2018 we will be on a pretty good runway at that point.

Stuart Miller: And Steve let me just chime in and say that community count is Rick's least favorite number.

Stephen Kim: Yes, likewise.

Stuart Miller: It is the one number that is like three level – three dimensional chess trying to figure out there are a lot of moving parts as you go through the year. There is some prediction, anticipation, some guess work and it is because as demand

moves around a little bit, as weather impacts, as third party participants, you know, as we have moderated down our ownership of land we are more dependent on third parties – all of these pieces play a part in making a hard number to get your head around and so we do conservatize it a little bit as well.

Stephen Kim: Sure, well the good news is you always have price which you can use to modulate things too so that is good.

My second question relates to tax rates and I know that tax policy is certainly a very nebulous issue right now, however, it doesn't stop people from doing some – running some hypotheticals and I imagine your company is no different.

So obviously if the corporate tax rate were to drop that would be fairly straightforward, however, in the case of builders there is at least three things that seem to be coming up in conversations with investors that could be offsets and I was curious if you might be able to opine on in general sense an order of magnitude how this all may come out in the wash – those other three components, the reduction of the interest deductibility, energy tax credits and perhaps the manufacturer's deduction and maybe I am missing something else but could you give us a sense for what the relative order of magnitude is in terms of the size of the significance of these three pieces to your tax rate?

Stuart Miller: Well you are right. We have definitely looked and we are looking at each of the component parts. I will say that I have had a recent opportunity to listen to Steve Mnuchin, the Treasury Secretary, who seems to be in a lead position there.

And the two things that I take away from listening to him is that he is very smart, very thoughtful in his approach and I frankly derived a lot of confidence listening to him walk through the thinking.

The other thing that I walked away with is a sense that he and this administration are listening carefully knowing that there will be winners and losers, there will be ups and downs in any configuration of the tax revamp and so there is virtually no ability to draw a certainty today from what pieces and in what proportion they are going to be woven into a new tax program.

So with that Bruce why don't you take a swipe at giving some relative proportion to the various pieces?

Bruce Gross: Sure, you know, if you look at our current tax rate of 34% the question is going to be, you know, whether it goes down – what rate it goes down to but for the three items you mentioned Steve, energy credits which we do have some. We have a manufacturing credit and the interest deduction – corporate interest deduction.

Those three based on our current numbers are approximately 5% give or take so that would take the 34% rate down to about 20 – 29% or so – I am sorry there would be about 5% in total from those of a reduction from the 34% and if – I need to add just one more component. If the tax rate went down to 20% that is where we would get down to about a 5% reduction of call it 29%.

If the tax-rate was maybe coming down to 25% in conjunction with that then it would be pretty much a push and there wouldn't be any positive impact.

Stephen Kim: Got it okay so those last two sentences are very helpful. I appreciate that. Thanks very much.

Stuart Miller: Sure.

Coordinator: Our next question comes from Stephen East. Your line is now open from Wells Fargo.

Stephen East: Thank you. Good morning guys. Stuart, you gave a ton of information so I will try to keep my compound questions to a minimum here but on the order growth side of it obviously you have seen a lot of acceleration as you go through you talked about it but can you give us a bit more color about what is going on, where you are seeing it more? It sounded like entry level was a big part of it and yet at the same time your incentives have moved up and your growth rate was above your targeted rate so I am just trying to reconcile, you know, the incentives versus what you all are seeing on the ground and how you want to manage that demand as you move through the year?

Stuart Miller: Well let me have Jon give an answer there.

Jon Jaffe: Hi Steve. You know, you really see the absorption pace moderate by market so for example California and the Pacific Northwest are strongest from a pace.

You know, California is about 4.5 sales per community compared to our company average of 3 so in those markets you see less incentives - you see more pricing power and in other markets say a Tampa and Orlando when we saw a healthy pace there of 3.7 sales per community. Even in Houston we saw another improvement as we reduce our community count where sales pace picked up a little bit year-over-year.

So in those markets I'd say it affects both the starter price point and the move up price points. In Texas which is marketed as more flattish from the sales

pace standpoint there you see a differential where the first time buyer product moves at a faster pace than the move up product.

Stephen East: Got you okay and from an incentive perspective I assume as you go through the year we would expect to see that come down. Is that a fair expectation?

Jon Jaffe: Yes, that is what we expect as Bruce said in the winter months, December, January, you know, we saw more incentives and we have seen that come down and we would expect to see that to continue to come down.

Stephen East: Okay and then on the gross margin you all are comfortable with it moving back up to full year staying within your range and yet, you know, it surprised us, you know, below what we were expecting.

I guess a couple of things – given that you have got a lot of cost flowing through lumber etc. labor, land, you know, what gives you the comfort there that you are going to be able to one, not only cover that cost but make it up quite a bit and then how much in purchase accounting is embedded for WCI in that 20% to 22.5%?

Stuart Miller: Yes, let me start and then have Rick and Jon weigh in but, you know, as I said in my opening remarks, you know, some of what you saw in our gross margin reflects some of the sluggishness that we saw towards the end of last year. Remember that what we are selling two quarters ago we are closing now and, you know, as we went through the election season, as we went through some reconciliation in November, you know, the market was a little bit slower than reported and we saw that bleed into December at, you know, we went from, you know, kind of sluggish to better to strong in terms of sales.

So, you know, as you see things firm up there is a little bit less incentives and a little bit more price. Construction costs have been moving up at the same pace. We feel pretty comfortable as we look at our numbers, as we look at our backlog right now that our margins coming back up.

Rick Beckwitt: Yes I guess if I answer that Stephen is, you know, we are spot on with where we thought we would be for the quarter with regards to gross margins. I think that the analyst community put too much margin in the first half of the year than in the back half of the year. We are on the trajectory to get where we guided to.

With regard to WCI as Bruce said it will have about a 20 to 30 basis point impact in Q2 but given the fact that WCI had a low cost land position with high gross margins it will not negatively impact margins for this year on an annualized basis.

Stephen East: Okay, all right, thank you all.

Stuart Miller: Thank you.

Coordinator: Our next question comes from John Lovallo from Bank of America. Your line is now open.

John Lovallo: Hey guys thank you for taking my questions. First question would be the year-over-year decline in backlog conversion in the west. How much of that was due to weather and can you quantify potentially, you know, the impact on ASP and on potentially gross margin?

Jon Jaffe: This is Jon. For the most part it was due to weather with more impact in terms of starts than the closings but there were markets where things were impacted

as well. We couldn't complete landscaping which prevented us from getting C of O's as an example.

I think that, you know, we will make up the majority of that. It will push toward the back of the year and a little bit will slide into – we have multi-family type of for sale product in the Bay area as an example. Condominiums – that might push out, you know, beyond the year but I don't think that we will see any impact to our margins from those weather impacts and delays just some timing issues.

John Lovallo: Okay, that is helpful and then in the central division it looks like orders were actually down slightly in a – on a year-over-year basis. Can you give us a little color around that?

Rick Beckwitt: I think some of that is driven by the impact still slug – a little bit of sluggishness in Houston but with regards to Houston we have seen a pick up. We are starting to see a little bit of an increase in rig count and we still have a divergence in sales pace between the higher price and the lower price lines so Houston was a little soft but it looks like it is – the picture is getting a little brighter there as we move through the year.

John Lovallo: Okay.

Jon Jaffe: But you look at that – this is Jon – we strategically reduce our community count in Houston which brought the total community count in the central region down a little bit year over year and our sales pace was actually, you know, just up a tick year-over-year so I think it is pretty steady there and we are managing our portfolio of communities and adjusting it to the market conditions.

John Lovallo: Thanks very much guys.

Coordinator: Our next question comes from Michael Rehaut from J.P. Morgan. Your line is now open.

Michael Rehaut: Thanks, good morning everyone.

Stuart Miller: Good morning Mike.

Michael Rehaut: First question I just had, you know, Stuart I wanted to go back to some of your opening remarks about, you know, sales pace being better than expected and, you know, referring to some optimism in the market place.

And you mentioned that, you know, the sales pace, you know, when we look about the sales pace – excuse me, you know, we calculate if you kind of strip out WCI that sales pace was up about 7% year-over-year. That is versus, you know, roughly 5% - 5.5% in 4Q, 5% in 3Q so definitely a touch better but I was interested in, you know, if the sales pace increased materially, you know, throughout the quarter, during the quarter, you know, obviously you also have your typical spring selling season pickup but, you know, on a year-over-year basis if the sales pace increased materially or, you know, given that, you know, 7 is a little bit better than 5 just, you know, wanted to know if there is any other kind of metrics that, you know, are – is driving that commentary?

Stuart Miller: Okay, so I am not really sure where you get your 7 but let's put that aside and let's understand where my commentary comes from. Remember that when we are looking at our monthly year-over-year we are looking at comparison to last year so let's take seasonality out of the equation because we are looking at December to December, January to January, February to February - so the seasonality is injected at both sides.



And what we were seeing in terms of the numbers is a slower and lower comparison in December, a comparable comparison in January and a substantially higher comparison in February so that is the numerical side of the commentary but the empirical side is what I look to dovetail with the – with the number side as I think about these things and I try to think about them in real time and balance what we are hearing at the front line in the field from our customers and measure that up against what we are seeing in the numbers and so the commentary really derives from the kind of traffic patterns, the questions that people are talking about and the kinds of people that are showing up.

What we are starting to see – I think in my commentary I noted that the millennials are doubled up at about a 60% rate living at home with parents, relatives or roommates. It is at a 115 year high as reported in USA Today.

I don't know if that is exactly the right number but it is directionally interesting and we are starting to see some of that cohort start to come out to our sales centers and talk about the fact that, you know, rental rates are high, rental rates have been moving, rental rates create some instability and it is time to start thinking about buying a home, 30 year mortgage, fixing the monthly payment and looking at the possibilities and benefits of actual ownership dovetailing that with the banks talking about coming back to market.

These are the components that kind of make up my sense that there is something afoot in the market that is broader than just one month in a row positive comparison. So that is kind of where it comes from Mike.

Michael Rehaut: That's perfect and yes definitely thinking about it in terms of year over year so appreciate that.

I guess secondly just on WCI and obviously congrats on the closing of that transaction and it looks like you are going to extract a lot of value there. You know, I was interested in, you know, you mentioned that, you know, there is a low cost basis there and, you know, attractive margins.

At the same time you are going to have the typical purchase accounting impact on 2Q but once you work through that, you know, from my understanding purchase accounting typically doesn't impact what is, you know, the overall lot position as well and I was just curious to get a sense, you know maybe Bruce if you want to, you know, throw out some, you know, opine here or talk about, you know, what has been able to be worked through or worked out from an accounting perspective.

You know, how should we think about the gross margins from WCI because typically from my understanding those are written up as well? I don't know if there was different nuances or, you know, idiosyncrasies with this particular acquisition.

Bruce Gross: Well what I would say (Mike) is that as we go through the purchase accounting exercise we look at all the various assets and the assets will be – let's just to use an estimate, be somewhere close to the margins that we get within that marketplace where the assets are.

So as we are performing at a certain level we would expect these assets in that same market to be somewhere close. So the real purchase accounting impact is really in the second quarter as we write up backlog and then as you get beyond the second quarter for the most part the integration costs, the write up

of backlog is all behind us we expect and then for the second half of the year and beyond you get back to more normal type of margins that we would expect in that marketplace and that is probably the best way to think about it.

Michael Rehaut: And are margins in that – in your home Florida market above corporate average?

Bruce Gross: They are just a little bit ahead of the company average.

Michael Rehaut: Great, thank you.

Bruce Gross: Sure.

Stuart Miller: And let's take our last question now.

Coordinator: Our next question comes from Jade Rahmani from KBW. Your line is now open.

Jade Rahmani: Thanks very much. You mentioned WCI should be accretive for the full year 2017 primarily in the second half so just wanted to see if you could provide any commentary a bit high level regarding 2018.

You know, should the main areas of potential further improvement from that acquisition come through, the SG&A leverage and financial services?

Rick Beckwitt: Yes, this is Rick. We haven't really given any 2018 guidance. You could expect from my comments earlier that we will get SG&A leverage. You will see a benefit to some gross margin because of lower cost and operating efficiencies and as we move into the tail end of this year we will give guidance to – for 2018.

Jade Rahmani: And on the financial services side can you just provide further color on much of the uptick and title – any changes in to, you know, how you are marketing the product or any additional services you are offering homebuyers?

Bruce Gross: I could take that. We have a little static in the background but Jade title's first quarter is typically the lowest quarter of the year so that increase is on a very low base and essentially we just had some additional pricing in terms of the average sales price of the transactions we had during the quarter were higher on the same overhead base so we got additional leverage.

So percentage wise it looked really good but nominally it was really just a small increase.

Jade Rahmani: Thanks very much.

Stuart Miller: Okay, so with that let me say thank you to everybody for joining us. We feel really good about how our company is positioned and how the year is starting to shape up. We think that the overall environment is strong and we look forward to reporting back to you as we go through the rest of the year. Thank you.

Coordinator: That completes today's conference. Thank you for participating. You may disconnect at this time.

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