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Toll Brothers, Inc. (TOL)

Q3 2020 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good day and welcome to the Toll Brothers Third Quarter 2020 Earnings Conference Call.

All participants will be in listen-only mode. [Operator Instructions] After today's presentation, there will be an opportunity to ask questions. [Operator Instructions] Please note this event is being recorded.

I would now like to turn the conference over to Douglas Yearley, Chairman and Chief Executive Officer. Please go ahead.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Thank you, Cole.

Welcome and thank you for joining us. I hope you, your families and your colleagues are staying well.

With me on the call today are Marty Connor, Chief Financial Officer; Fred Cooper, Senior VP of Finance and Investor Relations; Wendy Marlett, Chief Marketing Officer; and Gregg Ziegler, Senior VP and Treasurer.

Before I begin, I ask you to read the statement on forward-looking information on our earnings release and on our website. I caution you that many statements on this call are forward-looking based on assumptions about the economy, world events, housing and financial markets, the current and long-term impact of the COVID-19 pandemic, and many other factors beyond our control that could significantly affect future results. Those listening on the web can e-mail questions to investorrelations@tollbrothers.com.

Now, let's begin. We are very pleased with our overall performance in our third quarter ended July 31. I will focus on the current sales environment and then turn it over to Marty to address the numbers.

Our third quarter net signed contracts of 2,833 homes and $2.2 billion were up 26% in units and 18% in dollars compared to one year ago, the highest third quarter ever in both units and dollars. Our contracts per community in the third quarter at 8.5 were the highest third quarter in 15 years. As for monthly cadence, May's contracts were down 21%, June's were up 76% and July's were up 31% versus one year ago. Demand in June was not stronger than July, it just had an easier comp to 2019. In fact, while the June contracts were the highest June in our history, our July contracts were the highest for any month in our history including the spring selling months of February, March and April when we historically sell the most homes.

The strong demand has continued so far into August with deposits trending even better than July, and also up significantly compared to the same three weeks last August. We remind you that for Toll Brothers non-binding reservation deposits are an indicator of current market conditions as they generally precede our binding contracts by about three weeks.

With the strength in demand, we increased prices in most of our communities this quarter. If this trend continues, we expect to keep raising prices. Our traffic to deposit ratio of 11.3% and our traffic to agreement ratio of 7.1% were by far our highest conversion ratios ever. Customers who visited our communities whether in person or online were intent on buying. We believe that there are many reasons why demand for our homes has surged, some are positive for the entire industry, but importantly, some are very specific to our luxury build-to-order business model. Historically low interest rates are an undeniable benefit to buyers across all segments of the market. 30-year mortgage rate at or below 3% are fueling tremendous affordability. For example, with a 3% versus 4% mortgage rate, a person can afford a $900,000 home versus an $800,000 home with the same monthly payment.

Now more than ever, our customers view their home as the most important place in the world, a sanctuary for their family and a place to work remotely. Additionally, many buyers want a new home and will only look at new homes. And with the importance of the home growing, they want to personalize their home more than ever by selecting their homesite, their architectural home design and options and finishes. Our build-to-order model is ideally suited to meet these growing trends.

With the ability to add structural options, our buyers can choose those elements that are best suited for their lifestyle. Our homes include desirable design features such as multiple high-tech home offices where family members can work efficiently in private, multigenerational suites for [indiscernible] (00:05:40) parents or adult kids still living at home, open floor plans with indoor/outdoor living and many other intelligent options for today's lifestyles. This quarter, our buyers added on average $181,000 or 23% in upgrades to the base price of their homes.

Favorable supply demand dynamics are also fueling the housing market with limited resale inventory pushing more demand into new homes. With existing single-family home inventory at 3.0 months versus a 20-year average of 5.7 months, we are well-positioned to capture a portion of the incremental demand driven by this tight supply. Limited resale inventory also means that our buyers who have a home to sell feel confident in their ability to transact.

Our primary customer demographic, college-educated professionals, is working from home much more and we believe this will continue long term. The unemployment rate for college graduates is lower than that of the population in general. Their job prospects appear to be holding up well which gives them confidence to buy a new home. In addition, they are more likely to have accumulated wealth from the strong stock market.

Another factor we see driving demand is millennial demographics. Millennials, many of whom are now in their 30s and forming families, are buying homes. They have wealth from a combined 20 to 30 years of work-generated savings which can enable them to afford a first home that is bigger and higher priced than the typical starter home. We are capturing an increasing share of these buyers with our more affordable luxury homes. About 25% of our sales involve a first-time buyer. On the flip side, this new nesting phenomenon is causing many baby boomers to accelerate their plans for downsizing in anticipation of retirement as that end of our business has also improved.

We are also benefiting from our attractive landholdings in desirable suburbs of major coastal cities. In these markets, we believe a desire for more spacious living while still remaining near to friends, family and the office is driving suburban demand for our homes. With the long-term increase in remote working, many people are now choosing to live where they want rather than where their job previously required. We've seen a significant increase in relocation traffic to our communities in Boise, Salt Lake City, Las Vegas and Reno, Metro Phoenix, Denver, Austin and, of course, Florida as people chase the sun.

In summary, we believe we are well-positioned to take advantage of the resurgent housing market which is being fueled by historically low mortgage rates, a paradigm shift in the way people view and use their home, a favorable supply/demand imbalance, and the positive long-term demographic and geographic trends. With our diversified offering of homes across a wide variety of price points, our broad geographic footprint, our build-to-order customization model, and our reputation for quality, value and service, we look forward to continued growth in fiscal 2021 and beyond.

Now, let me turn it over to Marty.

Martin P. Connor

Chief Financial Officer, Toll Brothers, Inc.

Thanks, Doug.

In fiscal year 2020's third quarter, we delivered 2,022 homes and generated revenues of $1.63 billion which were up 1.4% in units and down 7.4% in dollars from one year ago. Third quarter net income was $114.8 million or $0.90 per share diluted compared to $146.3 million and $1 per share diluted one year ago. Our third quarter-end backlog of 7,239 homes and $6.09 billion was up 6% in units and 4% in dollars. Our third quarter adjusted gross margin was 21.9% of home building revenues compared to 21% in the fiscal 2020 second quarter. We attribute the sequential improvement to the mix of product deliveries and solid execution by our teams in the field.

Our average delivered price per home was $805,000 in the quarter compared to $881,000 in the prior-year period. During the quarter, we delivered more homes in lower-priced markets which reflects our strategic expansion into more affordable luxury homes in attractive high-growth markets. Additionally, while our business model is primarily build-to-order, we also start some homes as spec and market them as quick delivery homes. Approximately 18% of our Q3 deliveries were quick delivery homes.

As Doug mentioned, we increased prices in most of our communities during the third quarter. Should the current strong demand continue, we will keep raising prices. We expect these price increases to help offset rising lumber cost and expected pressures on labor and other costs driven by the strong housing market.

SG&A as a percentage of home building revenues was 9.9% in the quarter compared to 10.6% in the quarter one year ago. SG&A was lower this year and this quarter due primarily to reduced head count and marketing spend as we started to benefit from the actions we took to reduce cost last quarter. As we discussed last quarter, we strategically delayed selling several of our completed apartment communities and other assets to allow market conditions to settle. As a result, joint venture, land sales and other income was $4 million during the third quarter. We don't expect to go to the market to sell any significant assets until the first half of fiscal 2021.

Our balance sheet remains strong. During the quarter, we fully repaid all borrowings that were outstanding under our bank revolving credit line. We ended our third quarter with $2.34 billion of liquidity including $559 million of cash and $1.78 billion available under our $1.9 billion revolving bank credit facility, which does not mature until November 2024. In fact, we have no significant debt maturities until 2022. During the quarter, we increased our liquidity by $335 million and reduced our net debt to capital ratio by 270 basis points.

Looking forward, we are projecting fourth quarter new home deliveries of between 2,400 and 2,550 homes with an average price of between $815,000 and $835,000. Our Q4 delivery guidance reflects the fact that our backlog is a bit less mature than usual because approximately a third of it was just sold in June and July. We expect adjusted home sales gross margin in our fourth quarter to be approximately 21.5% of home building revenues and interest in cost of sales to be approximately 2.6%. We project fourth quarter SG&A as a percentage of home building revenues to be approximately 9%. Fourth quarter other income, income from unconsolidated entities and land sales gross profit is expected to be approximately $5 million. We project the fourth quarter tax rate of approximately 26%, our fourth quarter weighted average share count is expected to be approximately 130 million with a weighted average diluted share count of 131.5 million for the full year.

Now, let me turn it back to Doug.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Thank you, Marty.

We are laser-focused on improving our return on equity. A key element of this is our land buying strategy. We are increasingly taking advantage of land banking, joint ventures and other ways to optioned land. We improved our optioned to owned land ratio at quarter end to 43% optioned and 57% owned versus 40% optioned and 60% owned at last quarter-end. We also reduced our total lots owned and controlled by approximately 1,000 lots. And we are also focusing on lower-priced, higher-volume communities which generate higher ROA.

With 61,440 lots owned or optioned, 17,100 of which were already improved, we remain selective in investing in new land acquisitions and land development. In the third quarter, we limited our spending on new land acquisitions to $51 million. This is partly due to our solid existing land position, as well as to the hold we put on land spend at the start of the pandemic. More importantly, we've built more rigorous underwriting thresholds for both higher gross margin and return on investment into our project budgets for new land deals. This is reflected in our impairments during the quarter which were all associated with decisions to walk away from or sell land that did not meet our new underwriting thresholds.

We project a 2020 fiscal year-end community count of approximately 320 communities. This is due to a faster-than-expected sellout of existing communities and the intentional slowdown of new openings in March through mid-May during the early and uncertain days of the pandemic. However, we believe fiscal year 2021 will be a year of significant growth for us. Based on the land we currently own or control, we expect to grow community count by at least 10% by the end of fiscal 2021.

Before I open it up for questions, I want to thank the entire Toll Brothers team for the results we've produced this quarter. We are driving our great culture to even higher standards. We all wake up every day striving to be the best and our performance this quarter attest to this competitive spirit that is ingrained in our culture. The tremendous performance is a direct result of our commitment to providing our customers with the highest quality, value and services. This is the cornerstone of our reputation and the heart of our brand.

Now, Cole, let me open it up for questions.

QUESTION AND ANSWER SECTION

Operator: We will now begin the question-and-answer session. [Operator Instructions] And our first question today will come from Alan Ratner with Zelman & Associates. Please go ahead.

Alan Ratner
Analyst, Zelman & Associates

Q

Thank you, guys. Hey, guys. Good morning and congrats on the great results and glad to hear you guys are all doing well there.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Thanks, Alan.

Alan Ratner
Analyst, Zelman & Associates

Q

Doug and Marty, I guess, first I'll just kind of throw a question just kind of thinking about the volume-focused strategy here. The community count guide for 2021 is very encouraging. It sounds like you're not seeing a ton of big delays on the development side lingering from the early days of the pandemic which is great. So, I guess, as we think about the next 12 months or so, assuming demand does stay strong, is it reasonable to expect that you would be kind of willing and able to let the volume, the absorption paces run a little bit harder than perhaps you traditionally have given that large supply of communities you've got coming online, or are there constraints in the system whether it's labor, whether it's something in the supply chain that you think is kind of you're bumping up against a point where perhaps the absorption pace might have to flatline a little bit here just to kind of let the system catch up.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

It's a great question. Yes, we have the land, as I just described. Next year, we expect to open north of 150 new communities and I know the question will come up, so I will answer it now that they are spread pretty well across the country. Every region, for us, has at least 25 projected new openings in 2021.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

They are also reasonably consistent across the year, back-end loaded or front-end loaded.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Right. Thanks, Marty. That is correct. And so, yes, the land entitlement, the land improval process is back on track and we are really excited about our growth opportunities in 2021. More specifically to your exact question, I think we always do a good job of balancing pace and price. And as our backlogs grow in certain locations and as we become concerned as the industry will with labor because of the very strong sales that Toll and others are experiencing, we will be closely monitoring our ability to deliver houses in time frames that are acceptable to us. And if the production schedules extent because of those issues and we will more aggressively raise the price to manage those backlogs and manage the delivery dates. It is very local, it is community by community based on our sales pace, based on the complexity of our homes and how long they take to build when we don't have labor issues, but that is something that we are very keen to and if this demand continues which right now it sure feels like it will, I think you will see us continue to raise price and balance price with pace.

Alan Ratner
Analyst, Zelman & Associates

Q

Got it. Very helpful. Thank you for that, Doug. And second question, probably more for Marty, you guys mentioned the focus on ROE and a big pillar of that pre-pandemic was the share repurchase program which obviously has been put on hold here. But just curious if you can you give us an updated thought in terms of when you guys might be back in the market there because that obviously is probably the biggest lever you could pull to get that return back up to the just kind of the mid-teens level you were running at previously.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Alan, it's something that we are studying on a daily basis now as to what the landscape looks like for our future land spend, our cash generation, and the pricing of the stock. We've used the tool before. It's not unreasonable to expect us to use the tool in the future.

Alan Ratner
Analyst, Zelman & Associates

Q

Okay. Thanks a lot. Good luck, guys.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Thank you very much.

Operator: And our next question will come from Stephen Kim with Evercore ISI. Please go ahead. Hello, Mr. Kim, your line is open.

Stephen Kim
Analyst, Evercore ISI

Q

Thanks very much. Apologies for that. Congratulations on the strong results.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Thank you.

Stephen Kim
Analyst, Evercore ISI

Q

My first question relates to, yeah, an interesting comment you made about 23% in upgrades. Just wanted to make sure I got exactly what the wording was around that 23%. I wanted to see if you could provide some historical perspective around that number. When was the last time we saw a number at that level or greater? And am I right in remembering that generally speaking on the upgrades, you get more in the margin or a higher margin on those upgrades than your company average?

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Okay, so that 23% was on closing. So, you have to go back not for every sale, but for many sales you go back pre-pandemic. Although people maybe in the design studio from a home they bought in January, February, they may be in that design studio process post pandemic, they may have been in the design studio process when the rates came down, which makes them feel certainly that they can afford more home, and they're going to spend it on the beautiful finishes. We generally run about 20%. So, yes, it has spiked a little bit and I think we'll just have to see how that plays out. There is no question that with the home being so important today, with the nesting phenomenon that I just firmly believe in and I'm watching play out, there is no question with that occurring and with rates where they are, people are putting more into their house, they want to customize it, they're spending more time there. It is more important to them and I think it bodes really well for our business model.

Stephen Kim
Analyst, Evercore ISI

Q

Yeah, no doubt. Just as a follow-on to that, I was curious if you could give us a sense for what was like the highest level we've seen on that ratio, if we go back to history and how high did it ever get just as a point of curiosity.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

That would be August 26, 2020. We are at the high watermark.

Stephen Kim
Analyst, Evercore ISI

Q

Nice, okay. You talked also about the August deposits being better than they were in July and better than year-ago August, but I didn't hear any figures. Maybe I missed it. Can you give us some more clarity around what that number, percent increase was in August, maybe what it was in July, and was it an easy comp?

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

In July, it was in the high 40% range for deposits. We have exceeded that in August. It's only three weeks. We've always given you guys I think good commentary. I know last quarter, when we were right in the midst of some of the most troubling times of the pandemic and everybody was craving daily, weekly information, we got more specific for you, because things were changing rapidly right in front of us, but I'm comfortable with what we said in the prepared comments and what I just added and let's leave it at that. The market is very strong. We are seeing a terrific end to the summer.

Stephen Kim
Analyst, Evercore ISI

Q

Yeah, no doubt. Well, that's bigger than us. Thanks a lot, guys, and good luck for the next quarter.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

You're very welcome. Thank you.

Operator: And our next question will come from Jack Micenko with SIG. Please go ahead.

Jack Micenko
Analyst, Susquehanna International Group, LLP

Q

Hey, guys. Good morning.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Hi, Jack.

Jack Micenko
Analyst, Susquehanna International Group, LLP

Q

Speaking about next year's community count growth and the ongoing strategy to remix both geographically and on price point, how do you feel about the $805,000 ASP this quarter, down about 9% year over year, it's a bigger step down last quarter on a year to year? Just thinking about as we go into 2021 and you open these 150 new communities, do we see further reduction in ASP overall or we're kind of at a somewhat of a terminal velocity in terms of where that number is going based on the forward view?

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Jack, I think the mix of our offerings and the mix of our geographies is driving that number down a bit and will continue to do so in 2021. We're expanding the affordable luxury offerings. We're seeing great success in some of the acquisition of builders that we have added to the fold and those are all lower-priced markets and lower-priced products. And our product mix in some of our higher-priced markets is shifting to a bit lower average delivery price including in Southern California where we're seeing great success in LA County, and good success in Orange County, but not comparable to where it was a few years ago.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

We just have less.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Yeah. Right.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

We have a lot less in Orange County. But, Jack, with our range of homes from $300,000 to $3 million, the number can float quarter to quarter because it's just such a dramatic range of pricing. I mean, as an example, next quarter we guided to $815,000 to $835,000, which is up. The longer term – based on the expansion in the markets Marty mentioned and some of the builder acquisitions, longer term, we think it should trend down a little bit.

Jack Micenko
Analyst, Susquehanna International Group, LLP

Q

Okay, great. Thanks. And then on the expense side, I think last quarter you talked about a $50 million annualized run rate, I mean, I know there are some variable in the G&A obviously with better volume too. But should we think about the expense dollars – are we fully now implemented in that efficiency program from last quarter? Is there still more dollars to come out into the end of the year?

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

I think we are reflecting in this quarter most of the initiatives we took last quarter, but that does not mean that we have stopped initiatives.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Right.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

So, we continue to study ways to reduce costs further and we think from a G&A perspective, the dollar should be relatively stable.

Jack Micenko
Analyst, Susquehanna International Group, LLP

Q

Okay, great. Thank you, guys.

Operator: And our next question will come from Truman Patterson with Wells Fargo. Please go ahead.

Truman Patterson
Analyst, Wells Fargo Securities

Q

Hi. Good morning, guys. Thanks for taking my question and a really nice quarter overall. First, just wanted to touch back on community count, could you just discuss your level of confidence in the 2021 guidance of growth up 10% plus? I mean, that's pretty strong and we've been hearing that there is delays with zoning boards, city council meetings, permitting et cetera, and also some issues on the horizontal development front as well. I guess, could you just discuss some of these challenges on what you're seeing in the industry today, and just the level of confidence of you being able to hit that kind of 10% plus growth guidance?

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Sure. Remember, we shutdown land development, municipalities and counties shutdown meetings from mid-March until mid-May and then they figured out how to go Zoom meetings and we decided to start spending money on land development when the market showed signs of improvement which was right around a week or two before our May call. And so, let's just call it a two-month delay either strategically on our part where we stop putting roads in or where towns and counties just weren't ready to continue processing permits and having public hearings on approvals, but now that's all back in action. The towns are either open or they have fully figured out much like our children who have fully figured out how to go to school from their bedroom, how to hold meetings and how to work Zoom and Webex.

And so, the good news of what I'm telling you is that there are many communities that we're not hoping to get in to the second half of 2021, now we were hoping to open in the fourth quarter of 2020 and are now just naturally been pushed into the early parts of 2021. So, that gives us great confidence on a significant portion of what our future community openings look like. As for the balance, there can always be issues with that last permit that you think you're getting that is delayed for one reason or another. There could possibly be some modest land development delays as the land development companies that move the dirt and put the roads in find themselves with more work. That's all part of the business. We evaluate that, we factor that in and I am quite confident that the guidance we're giving you is we are able to hit it or exceed it. Also remember my words, it is based upon lands that today we own or control. There are more opportunities to buy land that will have roads in that will allow us to open. There are always opportunities for M&A. Last year, we acquired several builders that added lots immediately.

So, long answer to your question is I can't tell you it's an absolute definite, I can tell you that there are no potential issues, but overall when I look at the guidance and I look at our book, I feel really good about our ability to hit or beat it.

Truman Patterson
Analyst, Wells Fargo Securities

Q

Okay, okay, perfect. And then a two-part question on demand. Seems like every price point is working right, but could you just rank order the more affordable luxury, luxury active adult in terms of relative performance and then mid-Atlantic specifically, I mean, 60% order growth? What are you seeing there? Are you all getting a bit more traction with your community count? I know that's been an issue in the past just kind of everything that's occurring in the mid-Atlantic currently.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Sure. So, let me first – I'll hit the mid-Atlantic last for you. Affordable luxury, in every market, that's a different price, but generally, let's call it for Toll Brothers high 3s to $600,000 is the strongest. Luxury, which, let's call it, again it's market specific, but north of $600,000 would rank number two. Age-targeted and age-restricted and we put those in together because it's the same demographic whether they're buying in a community where 43-year olds can live or whether they're buying in a community where everybody is 55 and over, it's still the move down empty nester home, that group has been slower to recover until recently, but we're seeing strong growth of late. And it makes sense, that group has been more cautious about getting back out in the world because they are a bit more exposed or at risk with the pandemic and many of our age-targeted/age-restricted communities are destination communities chasing the sun in Florida, going out to Scottsdale et cetera, and they are just not traveling as much.

What's interesting, we have a lot of active adults age-targeted activity in Reno and Reno is unbelievably hot and people can make the drive from the Bay Area to Reno, they don't have to jump on the airplane, they can take a nice leisurely drive over the mountains through Tahoe into Reno, and I guess what, guys, about three hours, and so they're able to access it and it's been very strong.

So, while age-targeted/age-restricted has been behind affordable luxury and luxury, of late we are very encouraged. City living, as you would expect, is not doing well. Thankfully, we have our smallest number of buildings and number of units in New York urban which is Georgia city, Hoboken and Manhattan. As we've had in the last decade, there has been some activity lately, but it is slow and we expected it to be slow. The counterbalance is the suburbs of New Jersey, New York, Connecticut are extremely hot.

So, in terms of the mix of our product, there is my answer. With respect to...

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc. A

Mid-Atlantic.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc. A

...mid-Atlantic, go ahead, Marty.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc. A

I think most of that story, Truman, is Atlanta and our acquisitions there. Last year, we closed on Sharp acquisition in late May, so call it two-thirds of a quarter compared to a full quarter this year. And the Atlanta market has been spectacular for us, we are up 300% in Atlanta in agreements this year versus last year. Virginia is also very strong for us this year.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc. A

Yeah. I was going to say in addition to the addition of Atlanta, northern Virginia is showing great strength, really exciting what's going on there.

Truman Patterson
Analyst, Wells Fargo Securities Q

All right. Thank you, guys. Appreciate it.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc. A

You're very welcome, Truman. Take care.

Operator: And our next question will come from Jay McCanless with Wedbush Securities. Please go ahead.

Jay McCanless
Analyst, Wedbush Securities, Inc. Q

Hey, good morning, and congrats on a great quarter. The first question I had, Doug, is just what are you guys seeing from competitors? Are they able to push price like you guys are and how, I guess, are you seeing any of the land deals you may have walked away from earlier in the year come back to you?

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc. A

I'll start with land, yes, we are seeing some land deals come back. We didn't walk away from all that many because it wasn't – we just weren't sure in mid-March, early April what August would look like. We never thought it would look like this, but we just weren't sure. So, it was really a question of extending with our sellers, extending due diligence, extending closings, restructuring deals to be more capital efficient. And so, I'd say there is many less that were walked away from as there were – that were restructured to make better sense not only in terms of what the world looked like in April, but make better sense in terms of our real laser-focus on capital efficiency.

So, I am pleased with the land environment and I am very pleased with our ability to structure deals today with this really strong focus on ROI or ROE. Competitor – the land market, now that the housing market looks good, has become more competitive. There is no question we and the others are looking for growth opportunities and are continuing to pay up for good land.

In terms of pricing, yes, with the lack of supply on the resale market, with interest rates where they are, with this very strong demand that we are seeing, we have been aggressively raising prices, our competition as best I know is doing the same. I can't comment as much on the lower price range because we're just not down there all that much, our affordable luxury still is a notch above for the most part where many of the other at least publics play, so I can't comment as much on that, but in our business, we and others are raising prices.

Jay McCanless
Analyst, Wedbush Securities, Inc.

Q

Great. And then just the other question I had was on cycle times. Can you talk about where they are now and your comfort levels being able to sell these homes and get them delivered in a timely fashion?

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Cycle times have extended a little bit, some of that is front-end permitting, it may be taking the town another week or ten days to turn around the building permit application. There could be a little bit of extension on the many inspections that go into inspecting a home by the township officials. There are limited delays on the jobsite from COVID-19 health and safety protocols that require some social distancing and less workers in homes, but I think we're managing that pretty well.

I think what we need to watch is how some potential labor shortages as these homes that have sold get to the stage of needing the attention of the plumber or the electrician or the dry-wall hanger or the painter, we'll have to manage that down the road. We are expecting there to be some modest delays and we have, I think, properly budgeted for that and properly communicated with all of our trade partners, so they are fully aware of what's coming and they too can prepare.

Jay McCanless
Analyst, Wedbush Securities, Inc.

Q

Got it. That's great. Thanks again for taking the questions.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Thanks, Jay.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Thank you.

Operator: And our next question will come from John Lovallo with Bank of America Merrill Lynch. Please go ahead.

John Lovallo
Analyst, Bank of America Merrill Lynch

Q

Hey, guys. Thank you for taking my questions. The first one, as you alluded to, I mean, lumber prices are clearly up very significantly. Structural panels are up pretty significantly as well. Other materials in the bucket that you're seeing rise pretty meaningfully and along those same lines, I mean, what do you anticipate sort of as the magnitude of price increases needed to offset what you're seeing in input costs today?

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

As for other materials, any increases have been very modest and I think, obviously, the big focus is lumber, it is the number one material that goes into the construction of a home. If we could manage it to raise prices a couple of thousand dollars a quarter, call it $8,000 a year which would be 1% on our average house of $800,000, we would feel like we are in good shape in terms of managing or offsetting those increases. And with the strength of the market through the last couple of months and what I believe will be continued strength, I am very confident that we will be in very good shape with what we are achieving with price increases versus the building cost increases.

John Lovallo
Analyst, Bank of America Merrill Lynch

Q

Okay, that's helpful. And then in terms of expanding the affordable luxury offering that you have, you guys mentioned acquisitions a couple of times in the call today, just curious, I mean, does that acquisition initiative potentially include smaller public deals or are you focused exclusively on privates?

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

To date, we're focused on the small local private builder that gives us an entry into a new market or adds to an existing operation in one of our current markets. There was a couple of deals we were playing with before the pandemic hit that we put on hold. Now, we're back in some discussions and we have a group that focuses exclusively on M&A. Last year was a big year for us, it's worked out very well and we will continue for the moment to look at those small add-on acquisitions, not to say something bigger could come along, but it's not on the radar screen at the moment.

John Lovallo
Analyst, Bank of America Merrill Lynch

Q

Thank you, guys.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

You're very welcome. Thank you.

Operator: And our next question will come from Matthew Bouley with Barclays. Please go ahead.

Matthew Bouley
Analyst, Barclays Capital, Inc.

Q

Hi. Thank you for taking the questions. I wanted to ask about the gross margin guidance for the fourth quarter. I guess, just firstly, what factors are driving the step-down sequentially, I believe it's about 40 basis points? And just secondly, and you talked about lumber prices, I mean, to what extent is lumber factored into that or is that more of a 2021 event? Thank you.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

I think most of the lumber situation will be a 2021 event as we are delivering homes with lumber purchased 9 to 12 months ago in them right now in the fourth quarter. I think the biggest driver of gross margin in the fourth quarter compared to the third quarter is our mix. Our mix in the third quarter was more positive than it will be or than it's anticipated to be in the fourth quarter and that's the biggest aspect of the 40 basis point change. We had good profitability out of the quick deliveries that I mentioned in the third quarter, it was greater than we normally get out of our quick deliveries and it's probably not appropriate for us to forecast that continuing into the fourth quarter.

Matthew Bouley
Analyst, Barclays Capital, Inc.

Q

Okay. Thank you for that Marty. And then secondly, the purchase of 600 lots, obviously, a little lighter than usual, you mentioned kind of the existing healthy land position and maybe some lingering effects of the pause from Q2, but you also mentioned lifting your underwriting hurdles. I guess, what are those hurdle rates now versus prior and how does that play into rising land prices and competition for land here, there's kind of an implication that land investment rate might run a little lower than average for a longer period here? Thank you.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Sure. So, I'm not going to get into the specific numbers behind the underwriting, it would take a – it wouldn't be a semester course in college, but it would, well, online we could probably be pretty efficient with it. But as I mentioned with our 60,000 plus lots owned or controlled with our focus on and 17,000 of those improved, it gives us great comfort and flexibility to be selective. We recognize fully the need to be more capital efficient. We recognize the need to drive ROAs. There are opportunities to be very competitive in land buying, the ROE goes more to structure. Sometimes, it doesn't have to involve the actual land seller, it can involve a land banker, it can involve a joint venture opportunity with a financial partner, it can involve a joint venture opportunity with another builder. So, we're seeing really good deal flow. We're able to structure deals that are driving ROE higher, we know that will take sometime to prove out because there is a long time between contracting for the land and delivering your first home.

We're focused on more affordable luxury, which by its nature has quick returns; smaller homes, less upgrades, faster construction cycle time, and that naturally leads to higher ROE. And there are good land opportunities in the affordable luxury end of our business. So, we are very active on the land side, but these new underwriting standards, we mean it, it is important to us, we are unwavering in our commitment to focus on ROE and capital efficiency, and we will continue to buy land intelligently, but I'm delighted to have the 60,000 and 17,000 improved to work off of.

Matthew Bouley
Analyst, Barclays Capital, Inc.

Q

Got it. Thanks for the color, Doug.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

You're very welcome. Thank you.

Operator: And our next question will come from Susan Maklari with Goldman Sachs. Please go ahead.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC

Q

Thank you. Good morning, everyone.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Good morning.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Good morning.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC

Q

My first question is, Marty, I just wanted to get a little more color on the commentary that you made in terms of the dispersion in margin between your quick delivery homes and your more traditional kind of core product. How has that been – I know you mentioned that it has gotten narrower more recently, but can you give us a sense of the more standardized gap that we should be expecting there and may be how that will come together over time?

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Well, it's definitely coming together, there is not as much a gap as there used to be and I don't think it's as big a deal as the commentary would imply it was. We're talking about an impact of 10 to 30 basis points from one quarter to another, from call it 20% of the sales, 18% of the sales. So, it was just a good quarter with respect to that impact and while we hope it continues, it's a little premature to say it will.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

But I will say that the quick deliveries that we had in early May are at a higher price today than they were then.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC

Q

Okay, all right. That's encouraging, that's good to hear. Can you also perhaps give us a little color on what you're seeing out in California, maybe how that market trended over the quarter, and what you've been seeing as we get into the fourth quarter there?

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

I think she asked...

A

California.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

...what are you seeing in California.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Yeah, I know, I'd just...

[indiscernible] (00:52:26)

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

California has – yeah, has – Gregg is saying, positive, which I know, thank you. California has been positive. As we mentioned, there has been a shift for – we used to have much more Southern Cal and Orange County to LA County that has now shifted where we have more in LA County to Orange County. It's still significantly above our company average price, but it's lower than what it had been when Orange County dominated and I am encouraged by the sales that we see out there. I'll put it in perspective for – we gave you the cadence for the company of agreements. So, let's just get in to the weeds and I'll give you the cadence for California, but I'm not going to do it for every state. So, May was down 44%...

A

This is contracts.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

...contracts...

A

Yeah.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

June was up 63%, July was up 42%. And remember, we already mentioned don't read anything into the June to July because the comp back to June of 2019 was easier, June of 2019 was a slower month than the comp of July 2020 back to July of 2019. So, the cadence of improvement is good that is continuing into August.

Susan Maklari
Analyst, Goldman Sachs & Co. LLC

Q

Okay. That color is very helpful. Thank you and good luck with everything.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.
A

Thank you, Susan.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.
A

Thank you.

Operator: And our next question will come from Mike Dahl with RBC Capital Markets. Please go ahead.

Mike Dahl
Analyst, RBC Capital Markets LLC
Q

Hi, thanks for taking my questions. Nice results. Doug and maybe Marty also, I wanted to go back to the discussion about returns and you've obviously highlighted a number of things that you're doing to drive returns higher over the next few years. One thing is that I wanted to ask about was really how you're thinking about City Living and the apartment rental business in the context of your return focus – obviously, profits notwithstanding the current slowdown, profits can always be a bit bumpy there and not good profitability, not necessarily always return friendly. So, any thoughts on different structures or ownerships for either your existing portfolio or as you look at new deals in the next few years?

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.
A

Sure. So, on the Toll Brothers Apartment Living front, it's holding up well. Our occupancies are still very strong, we like our locations. Remember, these buildings are new. There's a big, big difference between a 10-year-old apartment building and a brand-new one in terms of amenities and the finishes of the units and so, I'm very comfortable with the portfolio. We are being cautious with expansion. The underwriting is definitely up when it comes to the multi-family business and that is all done off balance sheet with partners. That will continue to be the business model, but we are being careful and I think the growth for the next 6 to 12 months until we have better visibility longer term will be slower.

But in terms of what we have in our strategy on what we will hold versus what we will sell is still intact and nicely through the last four months, we have been able to find equity partners, we have been able to find competitive debt for the buildings that were in process, and they are continuing on terms very similar to pre-pandemic and I think that's a testament to Toll Brothers as a partner and it's a testament to the quality of the land, the location and the way we execute, but we recognize that the right strategy now is to be cautious.

On City Living, I mentioned that we have the lowest investment in New York that we had in a decade. We are selling out of several buildings that are built and partially occupied, so we just have inventory units that we will continue to sell, and we have a few buildings that are in later stages of construction that also have in most cases plenty of sales with very few cancellations and we will complete those buildings and we will sell them out. Some of those are in joint venture, so they're already very capital efficient where we have minimized or reduced our risk. We do have a couple of landholdings where we had not started construction that we will continue and wait to evaluate the market before we go vertical. And in terms of future acquisitions, we are on the sidelines.

Mike Dahl
Analyst, RBC Capital Markets LLC

Q

Got it. Okay, that's helpful. Thank you. My second question just back on the lumber...

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Thanks, Mike.

Mike Dahl
Analyst, RBC Capital Markets LLC

Q

...back on the lumber side, the $8,000 needed to cover, I just wanted to ask a clarification there because I know...

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Mike, you cut – I'm sorry, you cut out for a minute, so you said $8,000 I heard.

Mike Dahl
Analyst, RBC Capital Markets LLC

Q

Oh, sorry. So, on the lumber comments around the $8,000 to cover the costs, I just wanted to clarify on that because obviously you're on a higher-priced home, you might scale your premium package a bit compared to average, but I still have a thought that your total package for what might be in the $30,000 range and spot lumber and panels are more than doubled year on year, so how much of that is just kind of the lag nature of you guys obviously having a very long delivery cycle, so that's just not being an impact until late next year versus something different that you've been [indiscernible] (00:59:16)?

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Yeah, I think when you look at lumber, you can't just take the spot rate where it was and the spot rate today because we contract in our panel plants for lumber based on our judgment oftentimes for more than we need for the next quarter or we have inventory onsite for future demand. Similarly, in our non-panel plant markets, we may price a home with the framer or the lumber supplier for the next quarter or two. So, we protect ourselves with some excess inventory or forward pricing from rapid movements. And I think most of the industry has seen lumber prices spike and contract as mills add capacity to capture revenue and I think many in the industry are optimistic that that will happen this year as well.

Mike Dahl
Analyst, RBC Capital Markets LLC

Q

Got it. Okay, thanks, Marty.

Operator: And our next question will come from Jade Rahmani with KBW. Please go ahead.

Jade Rahmani
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Thanks very much. I was wondering if you could provide a view as to whether you believe the increase in new home demand that we're seeing is sustainable on a multi-year basis or represents a pull-forward. One factor that could support the long-term argument is perhaps how far out the average Toll buyer is willing to contract in terms of anticipated closing. Could you give any thoughts around that?

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Sure. Just remember that before the pandemic, our first quarter orders were up 31%. So, we were seeing the beginnings of a really good spring selling season, the housing market was strong. That was, of course, at higher interest rates and I already talked of the story about the $900,000 versus $800,000 house and this incredible feeling of there's no place like home and nesting. I believe rates are going to stay low for some time, I believe this housing market will have strength long term. We do not feel pull-forward demand and so I am optimistic.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

I think, Jade, there's if you kind of look at some of the factors that we talked about at the outset of our call, low rates, it feels like they're going to be around a long time. The demographics associated with the millennials have years to run. The desirability of a home as a place of safety and sanctuary is high right now and I'm not sure what's going to reduce it in the future. And then, another aspect particularly at our price point is this workplace flexibility and the work-from-home and the desire to have, say, more space or appropriate space to accommodate that. I think second homes, as we see in many of our markets, are also something that people are gravitating to, particularly those who might have been caught in a circumstance they didn't want to be in during this pandemic.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

New, there is a – I can't overstate the move to new. New has always been on people's mind, many people only looked at new, I think that's stronger than ever. Nobody lived in the house, they can design it the way they want to design it, you can buy a used home and try to renovate it to create a suite for mom and dad, to try to create a home office out of the fifth bedroom in the basement, in the attic, but with new, it's been thought out in advance by us, by great architects. We have home offices that can handle multiple workers with private workstations, with the highest technology, the fastest Wi-Fi and connectability. The in-law suite, that has the exterior entrance, so the mom or dad can feel like they have their own little home within their kids' home. They can come in from the outside, but then the suite connects back in to the main house, the indoor/outdoor living with that sliding glass on the back of the house that opens the outdoors into the indoors.

There is so much about the new home in addition to the energy efficiency and the health of no one ever living in it that I think we are just so well positioned to take advantage of what I think is a longer-term trend. I know here at Toll Brothers, we are going to have great flexibility in the long term for remote working.

I have so many friends that talk about their companies are going to have great flexibility long term for remote working. That brings the home – in addition to the emotional connection now of nesting with the family with what we've all been through, that brings the importance of that home to a whole another level and that requires some level of customization and personalization that is exactly what we do.

And when you look at the resale market, the more expensive move-up homes are doing really, really well in terms of pace of sales and pricing. Our buyers are able to sell their homes and move up into ours and they want to design the home themselves for their lifestyle and that can be at $500,000, that doesn't have to be at $2 million. And now that we do more and more affordable luxury, we're offering that opportunity even at our lower price points and these millennials in their mid-thirties that are now buying homes, they have more wealth. Their first home will look different, it can be the affordable luxury Toll Brothers home that they can still customize. Sorry for being on the soapbox, but I am passionate about this, I love how we're positioned and the market is moving right into what we do and that is what we are seeing with these tremendous results.

Jade Rahmani
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Thanks for that. Just a quick follow-up on the City Living and Apartment Living. Could you remind us how much capital is tied up in both those business? I think the last update I had...

[indiscernible] (01:06:47)

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

You cut out, but I think you want to know how much we have invested, so we'll take a chance and answer that one.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

So, in City Living, we have approximately $400 million invested, which is a low point for us over the last decade or so. Let's say $200 million of that is in near-complete buildings and $50 million of it is in JVs and $150 million of it is in paused pieces of grounds for future projects.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

But within those nearly completed buildings, there are inventory units that are completed...

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Yes.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

...that are on the market for sale.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Yes. And then in Toll Brothers Apartment Living, our stabilized projects, there's five of them, we have a total of $7 million of net investment in it which gets to the capital efficiency long term of these buildings. In development, we have approximately $700 million of land or projects representing our piece of the equity or in some cases a 100% of the equity as we have not yet gone to market or outside.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

But that comes down as we bring in equity.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Right. We expect to recoup $350 million or so JV formations within the next 24 months.

Jade Rahmani
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Thank you very much.

Operator: And our next question will come from Michael Rehaut with JPMorgan Securities. Please go ahead.

Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

Thanks. Good morning or good afternoon now. Thanks for taking my question. Wanted to circle back to a couple of items you hit on earlier. First, you kind of hit on some of the trends throughout the quarter and the strength continuing to August which obviously sounds great and consistent with what we're hearing out there as well broadly speaking. You referred to June and July being record months, I was hoping to get a little bit of a breakdown around sales pace to kind of get a little bit of a better sense or context of how that trended during the quarter. Obviously, there is seasonality that comes into play as you get in to the back half of the year, but hopefully, if you could kind of walk through the average monthly orders, orders per month per community, throughout the quarter, May, June, July and into August that would be really helpful.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

So, Mike, I think when we gave you the monthly cadence of year-over-year agreements and then what I hope was helpful commentary on August, we answered your question. If I'm mistaken, please help me, but I feel like we answered it in pretty good detail.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

I don't think there was enough variability in our number of communities through the course of the quarter, the incremental to the data we gave you on the topside level.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

There you go.

Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

Okay. Marty, maybe we can follow up offline on that, if you have time this afternoon, then but yeah, if you are saying that the community count was pretty steady, that does help and solve through that, I guess. So, thanks for that.

I guess, maybe just a couple of others, I know, kind of towards the end of the call, so these can be pretty quick, I just wanted to clarify, appreciate the commentary around pricing and obviously that's kind of a new or the second derivative focus that people have right now in terms of all the robust demand and how that's translating into price, and Doug, you mentioned that you're raising prices across most of your communities currently, you used the word aggressively raising prices. So, when you talk about trying to cover the lumber costs, that if it's $2,000 a quarter, that would do it for what you're seeing currently over the next year, let's say, $8,000 for a home or 1% doesn't seem to be too aggressive. So, I was hoping to get a sense of what your current price increase cadence is, not to get too granular if you prefer not to, but just kind of a sense of what on average you're raising your price by quarter or by months today and how that might extrapolate into a full year annualized appreciation rate.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.
A

Sure. So, my reference to aggressive and if it wasn't clear, I apologize, was intended and I hope I did it correctly to certain communities that have had extremely strong demand, when we sell eight homes in a weekend, we raise the price on Monday and if we sell five more the next week, we're going to raise the price again the next Monday, and I call that aggressive. That is not across the board. I am not suggesting that we are selling eight homes in every community one week and five the next week, but there are some locations that have seen that type of demand and we react appropriately.

Generally, we raise the price at individual communities, not in markets in total, based on the results in a given week at that local community. So I want to make sure the word aggressive doesn't get taken out of context. With that said, most of our communities have had at least a 1% price increase over the last two months. Very, very few had less than that, and there are many that has had more than that. So, I am going to go to most that have had at least 1%, very few have had less than 1%, but many have had more than 1%, and Mike, that's about it as far as I think I'm going to go with it.

Michael Rehaut
Analyst, JPMorgan Securities LLC
Q

That's really helpful, Doug. And I appreciate that. One last quick one, if I could...

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.
A

Go ahead.

Michael Rehaut
Analyst, JPMorgan Securities LLC
Q

...you mentioned ROE and the focus on improvement there and you had a lot of great progress with your lot optioning now at 43%, where could you see that going? Obviously, you're kind of holding back a little bit right now in terms of land purchases and you want to see good community growth this year.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.
A

So, Mike, we cut out, I think – I'm sorry, you're cutting out a little bit, since you're not the only one that cut out, I hope it's not our line...

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.
A

Right.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

...but apologies, if it's a problem on our end. I've had the goal of getting to 50/50 and we are heading there. And once we get to 50/50, maybe I'll have the goal of the old days where we went the other way to 40/60, but right now I think it's a good goal to get to 50/50, we are making great progress. We are restructuring many existing deals to make them more capital efficient, whether that be through land banking joint ventures or just different terms with the seller, and new deals that come in, we are extremely focused on the capital efficiency. So, it is moving in the right direction and it will continue in that direction.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

It may not be linear...

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Correct.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

...it may bounce around depending on the particular timing of acquisition of lands...

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Right.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

...but the intent is to move in that direction.

Michael Rehaut
Analyst, JPMorgan Securities LLC

Q

Perfect, thank you.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

You're very welcome, thank you.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Thank you.

Operator: And our next question will come from Ken Zener with KeyBanc. Please go ahead.

Kenneth Zener
Analyst, KeyBanc Capital Markets, Inc.

Q

Afternoon all.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Good afternoon, Ken.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Good afternoon.

Kenneth Zener
Analyst, KeyBanc Capital Markets, Inc.

Q

Hi, I have two questions, I'll just go back to back. So, the first one is related to backlog cadence, with year-end – usually, your year-end backlog, given you have longer construction cycle, it's usually about 75% of your full year deliveries. Is there anything operationally that you're seeing post COVID, you talked about a younger backlog that would lead you to think that that pattern would change, that's my first question.

And the second one, just a little more specific...

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

I think it's the age of the backlog that got in to our guidance, as I mentioned, a third of the backlog was sold within the last couple of months. And then the extended cycle times that Doug talked about, some of which are associated with social distancing on the jobsite and we think we've been prudent in the guidance we've given and those are the main drivers.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Right.

Kenneth Zener
Analyst, KeyBanc Capital Markets, Inc.

Q

Right.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

The good news is that we do a bit more affordable luxury as that grows and I mentioned that's the hottest segment for us, those houses turn faster.

Kenneth Zener
Analyst, KeyBanc Capital Markets, Inc.

Q

Appreciate that. And then my second question, it's a bit more West Coast oriented but in December, given weather delays, we saw cancellations from what had been Metro Crossing, rather large project for you, but now it's a very different environment. Can you kind of may be update how, let's say, that as opposed to New York, how the tech industry which is very work-from-home oriented and would have benefited, I guess, Metro Crossing effective perhaps the suburban demand in the East Bay as opposed to Metro and then in Portland where there has been a lot of unrest...

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Sure.

[indiscernible] (01:17:41)

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Again, I apologize you cut out a little bit there, but I know where you're headed. There is no question that the benefits of Reno as an example and Boise, which is doing extremely well for us, is to a large extent from the out-migration from California and we're seeing more and more – a higher percentage of our traffic into Reno, into Boise, and into some other markets. Austin, Texas as an example is from California. But overall, I'm pleased with the suburban Bay Area sales. Not everybody is leaving. Some are and we have the right markets and the right communities, but there are still many that are staying and so we're seeing – I'm pleased with the sales that we're seeing in suburban San Francisco. I already mentioned suburban New York, same phenomenon, LA County, which is not city for us, but is suburban. They're all doing very well.

We have our eye on San Francisco for sure, because the tech companies seem to have announced that they'll be a bit more liberal with longer-term remote working, but that doesn't mean everybody runs. That may just mean they're going to work from their home, but they're going to stay in the Area, because the Area is a pretty cool place to live. It's expensive, but it's a pretty cool place to live. So overall, I'm pleased with what's going on in the Bay Area and I'm very pleased with how we positioned ourselves in those other markets for those who do want to leave California.

Kenneth Zener
Analyst, KeyBanc Capital Markets, Inc.

Q

Thank you.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Thanks, Ken.

Operator: And our next question will come from Alex Barron with Housing Research Center. Please go ahead.

Alex Barron
Analyst, Housing Research Center LLC

Q

Yeah, thank you for taking my question. So, last year, the other income, joint venture and land sales category was a pretty big driver of earnings. This year, I guess, it took a step backwards especially in this quarter, next quarter. And I think some of that was delays in sales of your apartment communities and stuff like that. So, do you have any guidance or at least directionally what you think next year that will look like?

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Well, Alex, we've intentionally chosen not to market some non-core assets and some apartments here in the back six months of fiscal year 2020, because we think the market conditions are a bit uncertain, they wouldn't be favorable to price. We expect to put those on the market as things settle a bit in 2021, but we're not going to give guidance on 2021 at this point because we think there is too much uncertainty out there.

Alex Barron
Analyst, Housing Research Center LLC

Q

Got it. My second question is regarding the active adults segment or population. Can you guys give us what percentage of your business does that represent today, what was it last year and do you feel it's trending up at this point or not?

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

Yeah, I mentioned that earlier that active adult empty nester whether you call it age-targeted or legally age-restricted was slower to return as that buyer is being more cautious and getting back out in the world and travel is restricted in some of our locations or destinations. But I'm very pleased with recent activity. August is up as I think that crowd gets back out and so, I'm encouraged for where it's headed.

Martin P. Connor
Chief Financial Officer, Toll Brothers, Inc.

A

Thanks, Alex.

Alex Barron
Analyst, Housing Research Center LLC

Q

And any sense of what percentage it is?

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

I don't have that. I'm sorry.

Alex Barron
Analyst, Housing Research Center LLC

Q

Okay. Thanks.

Douglas C. Yearley, Jr.
Chairman & Chief Executive Officer, Toll Brothers, Inc.

A

You're welcome.

Operator: And this concludes our question-and-answer session. I'd like to turn the conference back over to Doug Yearley for any closing remarks.

Douglas C. Yearley, Jr.

Chairman & Chief Executive Officer, Toll Brothers, Inc.

Cole, thank you very much. Thanks everyone for your time today. Please stay safe, stay healthy, and enjoy the last few weeks we have of summer of 2020 which has certainly been a unique summer. Take care, everyone. Thanks very much.

Operator: The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines at this time.