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Builder incentives: Just marketing, or the real deal?

Upgraded tile. Closing costs. Association fees. Builder incentives sell houses, but they may also come with unnoticed costs.
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Most new-home buyers find it hard to resist the lure of builder incentives -- paid closing costs, an allowance for free upgrades at the design center or interest-rate buy-downs. But are they really worth it? ¶ From the builder's perspective, such incentives help sell homes faster, avoid price cuts, introduce available upgrades and expedite the sales process by encouraging buyers to use affiliated mortgage, title and escrow companies. ¶ However, as with all financial transactions, incentives should be considered with caveat emptor (buyer beware) in mind. Some generous-looking packages, on close inspection, may not be so generous, with higher closing costs and steeper interest rates contained in cumbersome mortgage documents. What's more, buyers may end up paying property taxes on a sale amount that includes not just upgrades to the home itself but also financial goodies such as pre-paid homeowners association fees or up-front closing costs.

For Tustin resident Glen Biener, a background in real estate and financial planning helped him get the sales incentives offered *and* nab competitively priced mortgages from builders William Lyon Homes and the Lennar Corp.

Last year, Biener closed on a new town home priced close to $650,000 at Lyon's Clarendon at Columbus Grove in the Tustin Legacy master-planned community. He said that he liked the $20,000 Lyon was offering for his choice of upgrades or closing costs but that he didn't think much of the financing initially offered by the builder's in-house mortgage arm.

Room for negotiation

"When I got the rate and their fee schedule, it was greater than what I was quoted by an outside broker, so I went back to Lyon," Biener said. "Their loan guy reduced the fees and the rate." Biener believes he got the reductions only because he knew what to ask for, and he said that the higher mortgage costs quickly would have eaten up any savings from incentives. William Lyon Homes did not return repeated calls for comment.

Biener also said he discovered the builder's design center didn't offer competitive prices. For instance, he said he found an outside tile retailer charging 40% less. So he opted for a flooring credit, and once he closed escrow, he replaced the standard carpeting with the tile of his choice. Although happy with his home purchase, Biener said his experience led him to conclude that a simple discount off the price of the home would have been far easier than dealing with incentives.

He may get his wish. According to Russell Valone, president and chief executive of MarketPointe Realty Advisors in San Diego, builders in Southern California have recently been reducing incentives in favor of lower prices. "Incentives really started disappearing when we saw the impact of the foreclosure market, and then it became a price war," he said, adding that incentives today typically are 1% to 2% of a new home's base price.

On a national scale, however, they remain popular with buyers. In fact, nine out of 10 new-home buyers in 33 markets surveyed for a study to be released this fall are receiving incentives; a quarter of those are worth $25,000 or more.

Paula Sonkin, vice president of real estate and construction industries for JD Power & Associates, said that, according to her preliminary results, about half these incentives were being used for upgrades, with most of the remainder applied toward closings costs or buying down the interest rate in the first few years of the mortgage.

Despite the wide attention paid to price guarantees -- in which a builder agrees to compensate buyers for any decline in value between the signing of a sales contract and closing -- they account for just 5% of all incentive options chosen.

Sonkin suggests that buyers do their homework before entering a sales office and, to protect their interests, bring their own real estate agent along on the first visit. They should also discuss the various property tax implications of incentives with their tax advisor.

"Options are nice, but if you're looking for financial savings, what implications do they have for property taxes and interest rates?" she asked.

In Biener's case, accepting incentives of more than $20,000 had a significant effect on his property tax bill. The hike in his bill was large enough to prompt him to seek a reassessment from an Orange County appeals board. Armed with detailed data he requested from Lyon on incentive types and amounts typically shared only with appraisers, Biener persuaded the county to lower his assessed value by $20,000, or the amount he said applied to closing costs alone.

Biener said he had a little different experience with Lennar, from whom he bought a town home priced close to $580,000 in early 2007 at the home builder's Camden Place @ Columbus Square, also in Tustin. He said that not only did Lennar decline to share the types and dollar amounts of incentives for neighboring homes he got from Lyon, but that the builder only agreed to lower the fees and interest rate on his in-house mortgage after he threatened to research his legal options. Lennar also did not return phone calls or e-mails requesting comment.

It's difficult to say what legal options Biener might have had at his disposal, since this area of the federal Real Estate Settlement Procedures Act is a bit murky. According to Brian Sullivan, a spokesman for the U.S. Department of Housing and Urban Development, Congress amended the act in 1983 to permit referrals between builders and real estate brokers and their affiliated companies -- such as those providing services for mortgages, title insurance and escrow -- as long as those affiliates remain under the same ownership.

However, buyers cannot be required to use these affiliates to purchase a property, nor can a broker or builder receive money in exchange for a referral. Moreover, builders and brokers must clearly disclose affiliate relationships in writing.

Consequently, HUD's Sullivan says that a "good" incentive for consumers is one that offers a true benefit without commensurate increases in fees or markups to make up for the original discounts; a "bad" incentive would be one that seeks to obscure the true price of the overall sale, including closing costs and lending fees.

An agent's advice

That's why enlisting the services of a real estate agent before visiting a new-home sales office could be useful. Kathleen Monroe, with Century 21 Beachside in Mission Viejo who has placed clients in new homes, says that although builder incentives include interest-rate buy-downs, optional upgrades and even price discounts, they usually come with strings attached that can complicate the process.

By providing clients with recent comparable sales, Monroe helps them determine the true value of a new home and whether the incentives being offered make sense.

Valid or not, time may be running out for free options and financing discounts at local new-home communities. Concludes MarketPointe's Valone: "Today, price is the key incentive. So most builders have opted to price the units as best they can."