Incentives That Draw Home Buyers Back Into the Market

Summary Findings of a Survey of Potential Home Buyers
January, 2009
Survey Conducted of U.S. Households in January, 2009

- Objective: Determine what will draw buyers back into the housing market
- Web-based survey of 712 U.S. consumers who consider themselves temporarily “on the sidelines” of the housing market
- Qualifying participants state they want to purchase a home within 6 months but are keeping themselves out of the market until conditions change, such as:
  - Improved housing market
  - Economy becomes more stable
  - Personal financial outlook improves
Other Studies Indicate Why *Home Builders* Think People Aren’t Buying Homes...

1. Buyers are concerned about economy and jobs
2. Cannot sell existing home
3. Worried about further home price declines

Question Series #1:

“What is keeping you from buying a home now or within six months? Rate the importance of each factor in your hesitating to purchase a home.”

Participants were asked to rate eleven factors on a 7-point scale, where:

1 = Not an issue at all
7 = Major issue
The Following Choices Were Provided

- Can’t make down payment
- Can’t afford payments for the house I want
- Don’t think I can qualify for mortgage financing
- Waiting for interest rates to fall further
- Too risky—housing prices may fall further
- Don’t think I can sell my current home
- Waiting for lower prices to get the best deal
- Haven’t found the right house or location
- Economy is too unstable for this commitment
- Personal reasons
- Another reason not mentioned above
Overall Reasons for Delaying a Home Purchase

(Percentage of respondents choosing 6 or 7 on the 7-point scale)

- Waiting for Interest Rates to Drop: 44%
- May Not Qualify for Financing: 41%
- Waiting for Home Price Decline: 38%
- Cannot Make Down Payment: 37%
- Have Not Found the Right House: 34%
- Cannot Afford the Payments: 34%
- Too Risky--Values May Fall More: 31%
- Unstable Economy: 31%
- Hard to Sell Current Home: 27%
Summary of Observations

- First and third responses indicate that there are many opportunists holding out for the best deal
- Second and fourth responses indicate buyer apprehension concerning qualifying for mortgage financing
- Bottom three responses reflect fear of continued housing and economic crisis
Reasons for Delaying by Home Purchase Price

(Percentage of respondents choosing 6 or 7 on the 7-point scale)

- Waiting for Interest Rates to Drop: 45% Home Price <$200,000, 42% Price $200,000+
- Waiting for Home Price Decline: 45% Home Price <$200,000, 42% Price $200,000+
- Have Not Found the Right House: 43% Home Price <$200,000, 39% Price $200,000+
- May Not Qualify for Financing: 42% Home Price <$200,000, 39% Price $200,000+
- Unstable Economy: 35% Home Price <$200,000, 34% Price $200,000+
- Cannot Afford the Payments: 34% Home Price <$200,000, 34% Price $200,000+
- Housing a Risky Investment: 32% Home Price <$200,000, 30% Price $200,000+
- Cannot Make Down Payment: 32% Home Price <$200,000, 28% Price $200,000+
- Hard to Sell Current Home: 27% Home Price <$200,000, 28% Price $200,000+
Differences by Home Purchase Price

- Higher-end home buyers are:
  - Most concerned about their ability to make a down payment
  - Concerned about qualifying for financing
  - Waiting for interest rates to drop

- Lower-end buyers are
  - Most driven by getting the best deal
  - More picky about finding the right house
  - Also fearful about not qualifying for financing
  - Less concerned about down payment
Reasons for Delaying by Owners vs. Renters

(Percentage of respondents choosing 6 or 7 on the 7-point scale)

- Waiting for Interest Rates to Drop
  - Current Home Owners: 45%
  - Current Renters: 39%

- May Not Qualify for Financing
  - Current Home Owners: 48%
  - Current Renters: 35%

- Waiting for Home Price Decline
  - Current Home Owners: 60%
  - Current Renters: 25%

- Cannot Make Down Payment
  - Current Home Owners: 9%
  - Current Renters: 58%

- Have Not Found the Right House
  - Current Home Owners: 56%
  - Current Renters: 20%

- Cannot Afford the Payments
  - Current Home Owners: 32%
  - Current Renters: 31%

- Housing a Risky Investment
  - Current Home Owners: 35%
  - Current Renters: 31%

- Unstable Economy
  - Current Home Owners: 44%
  - Current Renters: 22%
Differences Between Owners and Renters

- **Current home owners are**
  - Highly concerned about making the down payment (despite having made a down payment for their current home)
  - Somewhat concerned about qualifying for financing (despite having already obtained financing for their current home)
  - Less concerned about the economy or home price declines

- **Current renters are**
  - Most opportunistic—most are waiting for home prices to hit bottom
  - Much more picky about the buying the right home
  - More worried about not qualifying for financing
  - Much less worried about making the down payment
Reasons for Delaying Were Ranked in Each Region

Most Important = # 1
Least Important = # 9

(Highlighted boxes show rankings which vary noticeably from other regions)

<table>
<thead>
<tr>
<th>Reason</th>
<th>Northeast</th>
<th>Midwest</th>
<th>South</th>
<th>West</th>
</tr>
</thead>
<tbody>
<tr>
<td>Waiting for Interest Rates to Drop</td>
<td>#1</td>
<td>#1</td>
<td>#2</td>
<td>#3</td>
</tr>
<tr>
<td>May Not Qualify for Financing</td>
<td>#2</td>
<td>#5</td>
<td>#1</td>
<td>#2</td>
</tr>
<tr>
<td>Cannot Make Down Payment</td>
<td>#3</td>
<td>#2</td>
<td>#4</td>
<td>#7</td>
</tr>
<tr>
<td>Hard to Sell Current Home</td>
<td></td>
<td>#9</td>
<td>#9</td>
<td>#9</td>
</tr>
<tr>
<td>Cannot Afford the Payments</td>
<td>#5</td>
<td>#7</td>
<td>#5</td>
<td>#6</td>
</tr>
<tr>
<td>Unstable Economy</td>
<td>#6</td>
<td>#8</td>
<td>#6</td>
<td>#5</td>
</tr>
<tr>
<td>Housing a Risky Investment</td>
<td>#7</td>
<td>#6</td>
<td>#8</td>
<td>#8</td>
</tr>
<tr>
<td>Waiting for Home Price Decline</td>
<td></td>
<td>#4</td>
<td>#3</td>
<td>#1</td>
</tr>
<tr>
<td>Have Not Found the Right House</td>
<td>#9</td>
<td>#3</td>
<td>#7</td>
<td>#4</td>
</tr>
</tbody>
</table>
“The seller of your ideal home is offering an incentive package equaling 3% of the offering price of the home, up to $6,000....”

Participants were asked to choose one of the two incentives for this package:
- Interest rate buy down to 4.75% @ 30 years fixed, or
- Cash or equivalent of up to $6,000 provided at closing

“How likely would you purchase this home if it were offered to you with your incentive choice?”

Questions were repeated at the 5% and 10% incentive levels, with corresponding 4.25% and 3% interest rates
Percentage of Respondents Likely to Purchase at Various Incentive Levels

<table>
<thead>
<tr>
<th></th>
<th>3% Incentive</th>
<th>5% Incentive</th>
<th>10% Incentive</th>
</tr>
</thead>
<tbody>
<tr>
<td>Definitely Not</td>
<td>2%</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>Probably Not</td>
<td>2%</td>
<td>3%</td>
<td>2%</td>
</tr>
<tr>
<td>Maybe</td>
<td>38%</td>
<td>34%</td>
<td>18%</td>
</tr>
<tr>
<td>Probably</td>
<td>45%</td>
<td>43%</td>
<td>40%</td>
</tr>
<tr>
<td>Definitely</td>
<td>13%</td>
<td>19%</td>
<td>38%</td>
</tr>
<tr>
<td>TOTAL</td>
<td>100%</td>
<td>100%</td>
<td>100%</td>
</tr>
</tbody>
</table>
Differences by Buyer Demographics and Geography

- In general, high-end buyers were much more responsive to incentives.
- Buyers in the South were more receptive than other regions at all incentive levels.
- Buyers in the West were least receptive to the 3% incentive but were 2nd most receptive to the 10% incentive.
- Renters were more receptive to incentives than current home owners.
- Buyers in the Northeast were less receptive than other regions at the 10% incentive level.
- The cash or equivalent incentive was chosen somewhat more frequently at the 3% and 5% incentive level, while the interest rate buy down was chosen 2 to 1 at the 10% incentive level.
- Interest rate buy downs were more popular with older buyers (30+), cash or equivalent incentives were more popular with younger buyers.
Question Series #3
Trade-off Analysis of Incentives and Sales Features

- **Objective**—to evaluate the relative effectiveness of incentives and sales features for homes
- **Survey method** (conjoint analysis) provided realistic trade-off scenarios that home buyers experience in buying a home
- **Outcome** allows sellers to more accurately measure the effect of specific incentives and sales features on home sales
Incentives and Sales Features Tested

- **Interest Rates**—30-year, fixed-rate mortgage with interest rates ranging from 3% to 5%
- **Home Features**—overall house design and features
- **Down Payment**—ranging from 0% to 20% of purchase price
- **Mortgage Application**—buyers having confidence that their mortgage application will be accepted
- **Price**—home priced aggressively compared to market value, from 0% to 10% below market value
- **Transition Between Homes**—creative ways to help buyers transition between old and new homes including items such as the buyer leasing the new home or using sweat equity for a down payment
- **Free Upgrades**—home features or design changes valued from 0% to 10% of the price of the home, capped at $20,000
- **Incentive Package**—dollars used for upgrades, closing costs, or cash back to the buyer—up to 10% of purchase price
- **“Green” certified home**—from no extra cost to $2,000 extra
Interpreting and Applying the Results

- The Utility Score of an incentive or sales feature is the measure of its attractiveness to potential home buyers—higher scores are better.
- Just because an incentive or sales feature has a high Utility Score does not mean it is good value for the seller—the cost should always be taken into account.
- The best sales outcomes are expected when sellers offer the option or options that sum to the highest total utility score.
- This analysis is for the National market—how your geographic market or buyer segment may respond to these offerings may differ.
Utility Scores – Interest Rates

- No special financing: 0.20
- 5% 30 year mortgage: 0.62
- 3% for first 5 years, then 5.25% for remaining 25 years: 0.62
- 3% for first 10 years, then 5.25% for remaining 20 years: 0.75
- 4% 30 year mortgage: 0.86
- 3% 30 year mortgage: 1.19

Interest Rates:
- 0.62
- 0.20
- 0.0
- 0.2
- 0.4
- 0.6
- 0.8
- 1.0
- 1.2
- 1.4
Observations – Interest Rates

- Overall, low mortgage interest rates were especially attractive incentives, especially at 3%
  - Decrease in rates from 5% to 4% gained .24 points in Utility Score
  - Decrease in rates from 4% to 3% gained .33 points in Utility Score
- Home buyers may be very attracted to mortgage rate buy downs paid by seller
- Mortgages with low initial rates were attractive only when they had longer introductory rate periods (10 year)
Utility Scores – Home Features

- Location is good, house design and features are adequate: 0.09
- Location is good, house design and features are good: 0.88
- Location is good, house design and features are perfect: 1.21
Observations – Home Features

- Buyers in this market have very high expectations of the homes they want to purchase
- Buyers are intensely interested in purchasing a home with the “perfect” design and set of features
- An understanding of home buyer preferences is of paramount importance
- An “adequate” home has very little appeal in this market, even if the location is good
Utility Scores – Down Payment

- 20% down payment required: 0.18
- 10% down payment required: 0.50
- 5% down payment required: 0.79
- No down payment required: 1.10

20% down payment required:
10% down payment required:
5% down payment required:
No down payment required:
Observations – Down Payment

- Low, or no down payment home purchases are valued very highly
- There is a steadily increasing value associated with lower down payments
Utility Scores – Mortgage Application

Normal acceptance procedure: 0.19

Guaranteed acceptance if you have verifiable income and a fair credit score: 1.09
Observations – Mortgage Application

- There is a clear lack of confidence among potential home buyers concerning their ability to obtain financing
- This is true among those with Excellent, Good, and Fair FICO scores
Utility Scores – Home Price

Price is equal to the market value of the home
Price is 3% below the market value of the home
Price is 5% below the market value of the home
Price is 10% below the market value of the home
Observations – Price

- Lower prices are obviously more attractive
- Lowering prices, however, may not be a cost-effective way to attract buyers
  - Lowering price by 10% increases utility score by 0.65 points
  - A similar effect (increase of 0.61 points) can be obtained by moving from 20% to 5% down payment financing
  - This also compares to 0.90 points obtained from giving buyers confidence that their mortgage financing will be approved
- Sellers continuing to lower prices also has the unintended effect of announcing “prices haven’t hit bottom yet”
## Utility Scores – Transition Between Homes

<table>
<thead>
<tr>
<th>Transition Between Homes Options</th>
<th>Utility Score</th>
</tr>
</thead>
<tbody>
<tr>
<td>No transition options offered</td>
<td>.09</td>
</tr>
<tr>
<td>Builder or seller will buy my current home at 5% less than its current market value as a trade-in for the new home.</td>
<td>.37</td>
</tr>
<tr>
<td>Seller leases me the new home while my existing home is on the market.</td>
<td>.40</td>
</tr>
<tr>
<td>The home is offered through a rent-to-own program</td>
<td>.46</td>
</tr>
<tr>
<td>The builder rebates any loss in the appraised value of my new home in at the end of three years, and if they offer the same model I purchase for less after I sign the purchase contract, they will rebate the difference to me.</td>
<td>.48</td>
</tr>
<tr>
<td>Down payment of up to 5% paid for by your sweat equity for a new home (homebuyer may do landscaping, painting, final cleaning, etc.)</td>
<td>.49</td>
</tr>
<tr>
<td>The builder/seller will help me sell my old home by providing (at no cost) house-wide cleaning, some repainting, and interior furnishings for staging and provide a free temporary residence while the new home is under construction</td>
<td>.53</td>
</tr>
<tr>
<td>Seller will make my mortgage payments for first ten months.</td>
<td>.60</td>
</tr>
</tbody>
</table>
Observations – Transition Between Homes

- On average, these creative incentives didn’t have strong appeal, but some may come at a modest cost
  - “Sweat equity” is potential low-cost incentive with moderate value to builder or seller
  - Lease and rent-to-own programs may solve some seller short-term cash flow problems
- Perhaps the most costly option—mortgage payments made by seller—finished only slightly above the lower-cost options
Utility Scores – Free Upgrades

- No free upgrades included: 0.05
- Free upgrades, improvements, or home design changes that total 5% of the price of your new home, up to $10,000: 0.43
- Free upgrades, improvements, or home design changes that total 10% of the price of your new home, up to $20,000: 0.60
Observations – Free Upgrades

- Traditional home upgrades have a low benefit-to-cost ratio
- As the level of upgrades increases, their value to the seller has a diminishing return
  - When increasing from 0% to 5% in free upgrades, the Utility Score increases by .38 points
  - Increasing from 5% to 10% in free upgrades earns an increase of only .17 points
- Free upgrades at 10% of the home price (.60) is valued less by home buyers than a 5% reduction in price (.65)
Utility Scores – Cash or Equivalent Incentive

No incentive package offered  | Seller offers incentives valued at 3% of the price of the home | Seller offers incentives valued at 5% of the price of the home | Seller offers incentives valued at 10% of the price of the home

0.05 | 0.29 | 0.41 | 0.55
Observations – Cash or Equivalent Incentive

- This incentive was not a particularly good value to sellers
- The trend of diminishing value appeared again, with larger incentive packages having relatively little additional effect
Utility Scores – Green Certification

- The home is not green certified
- The home is certified as a green home and costs $2,000 over the standard home (0.08)
- The home is certified as a green home and costs $1,000 over the standard home (0.18)
- The home is certified as a green home but priced as a standard home (0.29)
- The home is certified as a green home and costs $1,000 over the standard home (0.45)
Observations – Green Certification

- Green home certification has nearly the same value as 5% in cash-equivalent incentives
- For many builders, the additional cost of green certification can be much less than 5%
- Green certification may be a significant distinguishing factor between homes once buyers have made the decision to purchase
- The biggest boost in Utility Score for “green” certification (.29 to .45) came from reducing the additional cost from $1,000 to nothing
  - This fact may indicate that offering homes with green certification as a standard feature may benefit a builder more than offering it as a low-cost option
Overall Conclusions and Recommendations

- Financial incentives seem to have more draw than many traditional incentives
- Builders/Sellers should understand & communicate current eligibility requirements for mortgage financing
  - Affirm that mortgage financing is not impossible
  - Line up mortgage providers & programs that accommodate needs & expected shortfalls
- Communicate that interest rates very likely have bottomed out, or offer to pay for mortgage rate buy downs
- Given the current state of the market, optimizing home design and sales features is crucial
- Offer incentives carefully—beyond a certain point, additional incentives are not effective in motivating buyers.
Recommendations for Market Segments

- Response to incentives will vary significantly by region and market segment—know your markets!

- For current home owners & move-up buyers:
  - Seek ways to help minimize down payment through appropriate financing programs (FHA, VA, etc.)
  - Consider ways to assist with down payment

- For current renters & low-end buyers:
  - Where possible, convey that prices are approaching bottom—now is a great time to buy. This is especially important in the West
  - Offer incentives that allay buyer fears of home value decline
  - This segment is the most difficult to convince that they have found “the right house,” so sharpen your understanding of their preference
Consider Sponsoring This Study for Your Market

- NAHB Research Center can tailor this study for your organization. You choose:
  - Range of incentives that are viable for your company
  - Geographic market(s)
  - Buyer demographics

- The results remain confidential
- Contact us to investigate this opportunity
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