



## The Difference between Construction/Development Costs and Home Prices

When the costs of developing a lot and building a home on it increase, the final price of the home to the ultimate buyer typically increases by more than the change in costs. This occurs because other costs, such as sales commissions and interest rates on construction loans, automatically rise. In addition, lenders will not usually make loans for development and construction unless the sale of the home is expected to generate some margin above costs.

NAHB has estimated the magnitude of these add-on costs in the specific case of [Government Regulation](#), but the same reasoning applies to other types of costs—such as increases in land or lumber prices—as well. The add-on percentage varies depending on when in the development/construction process the fee or other cost is incurred. The NAHB estimates show that the add-on charges range from 0 percent if a tax or other fee is imposed directly on the buyer when the home is purchased to 40 percent if cost is incurred when the developer applies for site approval:

Additional Charges Passed on to the Home Buyer Depending on When a Cost is Incurred	
0.0%	Cost imposed directly on buyer at closing
19.2%	Cost incurred by builder during construction
21.7%	Cost incurred at start of construction
22.3%	Cost incurred when applying for building permit
37.7%	Cost incurred during site development
<u>40.2%</u>	<u>Cost incurred when applying for development approval</u>

So if, for example, a \$1,000 fee is imposed on the builder when applying for a building permit, the final price of the new home to a buyer will increase by an estimated \$1,223. Or, looking at it the other way, it only takes an \$818 increase in costs incurred at the time of the building permit to raise the price of a home by \$1,000.

Estimating these add-on percentages requires certain assumptions about loan terms, lags in the development and construction process, normal profit margins, etc. The assumptions used by NAHB are fully documented in the appendix to the [Cost of Regulation](#) study.