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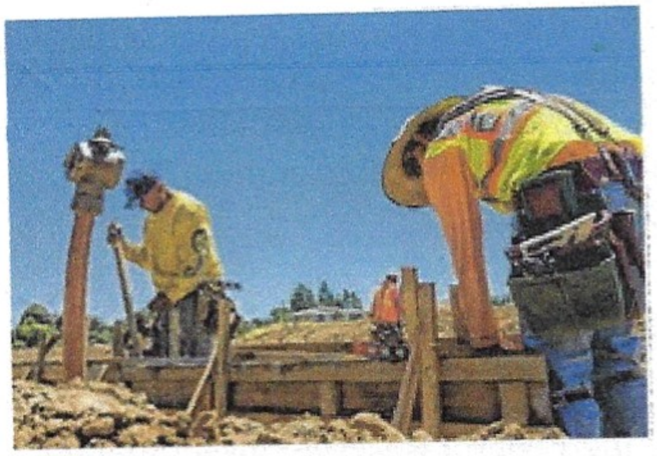

Toll Brothers said it increased its use of incentives in response to market softness in September and October. DAVID PAUL MORRIS/ BLOOMBERG NEWS

KB Home in September said its margins should improve in the fourth quarter if it can pull back on incentives to buyers. MIKE BLAKE/ REUTERS

The Cost of Buyer Incentives Looms Over Home Builders

BY DENNY JACOB

Lower-rate loans and other incentives have helped the biggest home builders sell new houses at a decent clip this year, even as stubbornly high mortgage rates weigh on sales of existing homes.

A drop in profit posted late last Wednesday by **Lennar** , however, shows how dependence on those incentives comes with a cost that threatens to drag on home builders into the new year amid fading prospects of lower interest rates. Lennar said the average price of each home sold slipped about 2.5% in the latest quarter, denting profit margins.

"The shortfall in margin resulted from increased incentives on homes sold and delivered within the quarter," said Stuart Miller, co-chief executive, on a call with analysts Thursday.

Lennar, which didn't respond to requests for additional comment, has leaned on incentives, such as rate buydowns and other closing cost reductions, at higher levels in 2024 than in the prior year. Sales incentives as a percentage of revenue were 10.1% through the first three quarters of fiscal 2024, up from 8.6% in 2023, according to a securities filing. During the fourth quarter, sales incentives rose to 10.8%.

The reliance on incentives mirrors that of other home builders. Given historically high mortgage rates and a resale market with few options as homeowners stay put while handcuffed to rates below 4%, incentives have been necessary to stimulate demand.

Luxury home builder **Toll Brothers** this month said it increased its use of incentives in response to market softness in September and October amid high mortgage rates and election uncertainty.

KB Home in September said third-quarter margins were slightly lower than in the prior two quarters, though it said it expected the metric to improve in the fourth quarter— if it can pull back on incentives. **PulteGroup** in October said it expected its margins to narrow sequentially going into the fourth quarter, in part reflecting a need to boost incentives.

"We expect incentives to remain elevated for at least the remainder of the year," PulteGroup Chief Financial Officer Bob O'Shaughnessy said following the release of the company's third-quarter results.

Despite the pressure on margins, the incentives have worked, helping the biggest home builders sell houses while the existing-home market has languished.

Sales of existing homes began to decline in January 2022 and have stayed low since the Federal Reserve raised interest rates to combat inflation. Although sales of existing homes made their biggest year-over-year gain in three years in November, they remain on track to hit their lowest level since 1995, data released Thursday show.

Sales of newly constructed homes have fared better, though they account for a small percentage of the total market. In 2024, they have at times jumped month over month with occasional retreats, echoing similar trends seen last year.

The question looming over builders in 2025 will be to what degree incentives will be necessary. In recent months, some speculated that buyerfriendly offers could wind down as mortgage rates settle and potentially come down. Such chances are now weaker after the Fed on Wednesday signaled greater doubt over how much it would continue to cut interest rates going forward following its latest reduction.

Adding to the broader uncertainty are some of President- elect Donald Trump's economic proposals, including broad tariffs and a crackdown on immigration, that will ripple through the housing and construction markets.

Challenges and uncertainty in the housing market may necessitate home builders to keep leaning on incentives even at the expense of margins in the short term. But Lennar, for one, still sees room for growth in the long term.

"We remain confident that the current volatility driven by affordability and interest rates will subside, [and] demand will adapt to a new normal," Miller said on the call. "Volume will continue to help reduce our cost structure and incentives will normalize and margins will normalize."