

How City Hall Exacerbates the Entry-Level Housing Squeeze

Higher fees for construction permits could be to blame for a shortage of starter homes

By NICK TIMIRAOS, May 5, 2016 8:35 am ET

The housing market has recovered, but sluggish entry-level construction is putting a squeeze on families that would like to buy their first home. A new report pins the blame on City Hall.

The culprit: Impact fees that builders have to pay municipalities when they get permits for new construction, says the report from Zelman & Associates, a housing research firm. These fees fund the local infrastructure needed to support a growing population—schools, transportation, environmental mitigation and utilities.

Cities boosted these impact fees after the downturn—even though builders were cutting prices—to make up for lost revenue. During and before the housing boom, these fees had supported municipal budgets, together with rising property taxes, which also stopped rising when prices fell.

[The upshot is that housing supply—and not demand](#)—could be more to blame for sluggish sales gains, particularly in the face of prices that continue to rise.

Builders have faced other cost constraints besides permitting fees in recent years, including rising costs of labor, land and supplies. But for entry-level construction, “this is the No. 1 impediment right now,” says Ivy Zelman, the research firm’s chief executive.

It’s a bigger issue at the entry level because builders face tighter margins to begin with. It is easier for them to pass along these fees on luxury homes that have fatter margins because the fees represent a smaller share of the sales price, and [builders have focused heavily on the luxury market in recent years](#). “The higher you go in home

price, the more you can pass those fees off to buyers,” says Ms. Zelman.

Zelman surveyed hundreds of builders across 37 metro areas and found that the average impact fee is up 45% since 2005, to around \$21,000. They range from as low as \$2,600 in Houston to \$72,000 in San Francisco. Six of the top seven most expensive average fees are in California metros. The other is the Washington, D.C., metro area.

For entry-level buyers, financing is also an issue. Many builders rely on loans backed by the Federal Housing Administration, which allows buyers to make down payments of just 3%. Ms. Zelman says as fees rise, builders are struggling to build homes that they can sell for prices below those FHA limits, which vary from county to county. This leaves builders with little margin to take the risk of building and selling entry-level homes..

Ms. Zelman says impact fees in the Inland Empire now average around \$50,000 per home, up from \$11,000 in 2005. If this home is going to sell at the FHA limit, the profit—that is, the incentive to build this home—has essentially been washed out by the impact fee.

“Builders won’t build it, and they won’t build it for a good reason,” says Ms. Zelman.