

This is a monthly column on the real estate market and related issues in the upper Hudson River Valley by Roderic H. Blackburn, principal of R. H. Blackburn & Associates, Inc.—Real Estate of Hudson and Kinderhook, NY. It also appears in *Capital District HomeStyle* magazine. blackburn@berk.com



Kost Veloren (Money thrown away) What's worth fixing in a home to resell

You own a house which has doubled in value in just five years, even more since you bought it many years earlier. Better yet, if you sell, subject to certain limits, you may not have to pay capital gains tax. Furthermore, if you have had a mortgage, your property may have generated all this gain with money borrowed at historically low rates. Best of all, you got to live in your home, share it, love it - that's priceless. What other investment cum comfort can come close to achieving that? None - at least none that is legal, prudent, or spouse-agreeable.

So now it may be time to sell. Time to downsize, shed the maintenance, be free to travel, and sock away more retirement funds. Maybe you simply wish to take advantage of a hot market before it cools. On the "bottom" side of the coin, however, you may be selling because of illness, divorce, bankruptcy, or death. As with these and other more positive experiences (birth and marriage, for example), for most people selling a home is an important emotional as well as financial turning point in their lives. So how should you take the best possible advantage of this decision? What will be easiest to do versus what will yield the best return? Do you have the available funds and personal fortitude to clear up basic property condition problems, perhaps also making some non-essential improvements - then patiently hold out for the best price? Or will you "cut and run," taking whatever the market serves up quickly? Let us follow Sally and John Miller as they go through the process of taking such a turn in their lives.

Sally and John have been married for thirty-five years and have owned their present home for twenty-six years. Their two children are now grown and married. Because the Millers' careers are still pumping along and personally

Just for reference, here are some project costs and payback rates for house improvements. They come from Remodeling Magazines' 2004 survey of the 18 most common projects in 60 cities, (www.remodeling.hw.net), one of many surveys conducted each year by various organizations. Take them with a grain of salt because if you look at surveys in different parts of the country and at different points in the market cycle, you will likely see considerably different cost and payback figures. The payback percentage is projected on house sales within a year. Note, there is nothing here which would suggest renovation pays for itself, much less creates a profit, at least financially. Of course remember that home improvements are as much about payback in pleasure as in greenbacks.

- Kitchen, minor remodel - avg. cost: \$15,273 - avg. return: 92.9%
- Kitchen, major remodel, mid-range - avg. cost: \$42,660 - avg. return: 79.4%
- Kitchen, major remodel, upscale - avg. cost: \$75,206 - avg. return: 80.3%
- Bathroom remodel, mid-range - avg. cost: \$9,861 - avg. return: 90.1%
- Bathroom remodel, upscale - avg. cost: \$25,273 - avg. return: 85.6%
- Bathroom addition, mid-range - avg. cost: \$21,087 - avg. return: 86.4%
- Bathroom addition, upscale - avg. cost: \$41,587 - avg. return: 81.1%
- Master suite addition, mid-range - avg. cost: \$70,245 - avg. return: 80.1%
- Master suite addition, upscale - avg. cost: \$134,364 - avg. return: 77.6%
- Family room addition - avg. cost: \$52,562 - avg. return: 80.6%
- Attic bedroom - avg. cost: \$35,960 - avg. return: 82.7%
- Basement remodel - avg. cost: \$47,888 - avg. return: 76.1%
- Deck addition - avg. cost: \$6,917 - avg. return: 86.7%
- Sunroom addition - avg. cost: \$31,063 - avg. return: 70.8%
- Window replacement, mid-range - avg. cost: \$9,127 - avg. return: 84.5%
- Window replacement, upscale - Avg. cost: \$15,383 - avg. return: 83.7%
- Siding replacement - avg. cost: \$6,946 - avg. return: 92.8%
- Roofing replacement - avg. cost: \$11,376 - avg. return: 80.8%

satisfying, the idea of full retirement at age sixty is unappealing. Since Social Security income will be only a fraction of what they will need when they do retire and their IRA's took a beating in the recent bear market in stocks, extended careers seem prudent. The house the Millers bought in 1980 in anticipation of a growing family now has an estimated market value of \$ 500,000, ten times what they originally paid for it. Of course and as to be expected, after all these years it is now a bit "worn at the edges" and could use some real renovation. It was State-of-the-Art twenty-six years ago, but now is so dated-

looking that it will have a hard time competing with new houses two-thirds its size or price.

The first question Sally and John face is whether to renovate or sell "as is." Is it worth spending money to make the house more immediately appealing? What about not-so-obvious problems like a boiler ready to give out, a roof going green with moss, a septic field becoming suspiciously soggy in the spring? Unless absolutely required to do so, many sellers don't make an effort to correct many house problems, let alone make cosmetic improvements. Often their minds and money are elsewhere. In a hot market an attractively built house with things to be done to it still has

appeal; it has "potential," "good bones," or is even a "fix and flip" candidate. But in a tepid market the adjectives change even if the house hasn't. It's now a "dog," "outdated," "déclassé," if not exactly a "dump" - yet. A major reason why a hot market sometimes tolerates a conditioned-challenged house is the expectation that the cost of renovation will be more than covered by fast appreciating value, not only because of the specific improvements to be undertaken, but also because property values are generally going up.

In a continuing hot market a \$500,000 house may be worth \$600,000 a year later, even without improvement.

With \$100,000 in renovation it might be worth \$700,000 - an excellent return on the "invested" \$ 100,000. The Millers are tempted to take on the challenge. But also consider the other side of the coin. If the market goes "quiet," buyers are hard to find, and/or too many listings come on the market too quickly, the result is asking prices start to drop in response to new imbalances of supply and demand. In such a disappointing market the choices for the Millers change. Their house may take much longer to sell, even at \$ 500,000. If they are motivated to sell quickly, they may be tempted to accept less, say \$450,000. Also, since "time is money;" they must also keep in mind that the cost of maintaining a house while on the market has "time value," given ongoing mortgage payments, repairs, utility costs, taxes and insurance premiums, expenses which can easily amount to \$30,000-60,000 a year. If the Millers hold out and are able to sell for \$500,000 a year later, they will have lost much of that "time value" money, while also exposing themselves to extended market risk. Then there is the loss of any potential non-real estate return. If Sally and John are able to sell right away at \$500,000 and invest their proceeds (which could be considerable), they might earn \$10,000-20,000 or more, even with relatively conservative investment strategies.

If the Millers undertake many of the improvements they think will make their house more appealing[(\$100,000)], they may well find, as surveys have shown, that the average improvement will not earn back its cost upon immediate resale and is even less likely to do so as time goes on and improvements depreciate in value. While their improved "\$500,000 house" should now be worth \$100,000 more, in fact in a tepid market improvements have on average only a 70-80% payback. In a cold market the payback may be even less. Much of their \$100,000 could actually be lost at resale. And the time required to complete improvements may keep the Millers' house off the market for as long as a year (and at ongoing expense) - after which they could face an additional year or more on the market to get it sold. So, what is the bottom line? Although the dynamics of choices like those facing the Millers are never simple, market temperature is often an overriding factor when considering whether to renovate or "take the money and run". Hot markets (for example, 1980-89, 1996-2005) often both bail out the foolish as well as reward the wise. However, tepid or cold markets (for example, 1973-1980, 1989-1996) equally often prove costly to all in terms of time value lost, especially when specific improvements have low payback and house prices are sliding.

So Sally and John, with good counsel from their realtor, choose to do something both prudent and reasonable. Not knowing whether "their" hot market will continue and personally averse to the risk of expensive improvements, they decide to identify just those condition issues which stand out as dangerous or substandard, regardless of the overall

condition of their home. Floor varnish and carpeting are worn in places and somewhat dirty. Some walls have worn or dated wallpaper, or need re-painting. The exterior siding is peeling in places. A chimney has a few loose bricks. Areas of the garden are getting weedy. A dead elm tree threatens the garage and other trees have grown up to block a view to the countryside. An in-ground fuel tank has been in place for an unknown number of years, a significant potential liability. An elevated radon level is detected when the Millers prudently hire a house inspector/engineer, who also finds a crack in the boiler's ceramic lining and moisture in a cellar crawl space (which has encouraged an infestation of powder post beetles).

All these and a few more minor condition issues are quickly addressed at a cost of \$20,000. The house looks brighter and cleaner. It now has no glaring problems. It is put on the market at a realistic price, that is no more than 15% above its likely selling point, and sells more quickly than the 250- day average market time being experienced recently by sellers in the Millers' geographic area. Their \$20,000 investment has fully paid for itself. \$100,000 in improvements and an extra year of regular expenses would not have.

Remember it is often overall perceived condition, along with square footage and property size, which is a major determinant of the price ultimately realized by a seller. However, unlike the latter two, which are quantifiable, condition is for many buyers and sellers highly subjective and more in the "eye of the beholder" than it should be. Unfortunately condition terms - like excellent, very good, good, fair, poor - are grossly inadequate for objectively assessing value. Yet these are the very terms commonly found in property listings. With billions of dollars at stake in one of the most important segments of our economy - existing homes - you would think the real estate profession would have developed far more objective criteria and terminology.

Although a good home inspection should identify most substandard and dangerous conditions, it won't give you the dollar figures needed to estimate market value. When a home inspection is coupled with reasonable rates of depreciation and remediation estimates, then useful condition figures can be incorporated into a property's market value calculation. Unfortunately this is not yet an objective, reliable process - however great its need. Terminology certainly needs to become more sophisticated in order to account for all of a home's features -- both subjectively and objectively. And, of course, what is considered fashionable may well be very different today from what it was just a few years ago. Furthermore what is "popular" is highly variable in different parts of the country, and for people of different social aspirations and income levels. More on this complicated subject in a later column.