ARE YOU 'OVER IMPROVING' YOUR HOME?
By Shelly K. Schwartz

There's no question, Americans are a home-improvement-happy bunch. Armed with equity loans and unprecedented appreciation in property values, homeowners continue to update kitchens, landscape gardens and finish basements at a frenetic pace -- rationalizing the billions of dollars they spend each year with cockeyed optimism that they'll "get it all back" at resale. Indeed, many will. Yet, as the dust settles on the real estate market and prices float back down to earth, some, too, will find they've spent far more updating their homes than they could ever recoup at the closing table. It's called over improving your home and millions have made the mistake.

"A lot of people who over-improved did a cash-out refinancing when rates were at a low, expecting housing prices to continue going up and up, "says Sal Alfano, editorial director for Remodeling Magazine in Washington. But in some places, like the Midwest, prices have already stopped climbing. With an average kitchen remodel alone costing $44,000, it's easier than you might think to turn the cost-versus-value equation on its head. "These days, projects are expensive", says Alfano. "You don't have to do a lot of remodeling to spend a lot of money. What usually happens is you'll get a leak in your bathroom and you figure it's a good time to do a remodel. It's magnificent when it's done, but suddenly the rest of the house looks pretty shabby. There's a snowball effect where one remodeling project tends to lead to another."
So what's the danger? Not much, if you plan to stay put. Chances are you'll own your home long enough to ride out any down cycles and allow annual appreciation to offset your investment. But if you plan to sell soon, or need to unexpectedly, a danger exists that you could owe more on your home than it's worth. Remember, home equity loans come due in full the moment of resale. "This is an issue because of how aggressive the lenders have been [in approving home equity loans to cash-strapped borrowers]," says Richard Roll, president of the American Homeowners Association in Stamford, Conn. "You could be in a position where you need to get 105 percent of the total debt on the property and you can only get 98 percent of that from a buyer."

Those who can afford to sell at a loss, of course, can pay the difference out of pocket. Those who can't face an unpleasant choice: Remain hostage in a home that no longer meets their needs, or, in an extreme case, lose the house if they can't make their loan payments. "Over the last 10 years, we've seen a fairly significant core of the population spending more than half the value of their home on improvements," says Kermit Baker, director of the remodeling futures program at the Harvard Joint Center for Housing Studies. "Some of that is because buyers increasingly are moving into older suburbs convenient to their jobs in the city, and they're renovating smaller Cape Cod and ranch-style homes."

Many of those homes have never been updated, he says, featuring a single bathroom and formal dining and living rooms. Buyers today are tearing down walls to create open spaces, adding large master bathrooms and expanding bedrooms for space. It doesn't come cheap. The center reports homeowners spent almost $127 billion on remodeling during 2004, up 6 percent over 2003. So how do you know if you've sunk too much into your biggest investment? That's a lot like asking whether you spent too much on your last vacation, says

Roll. Those with money to burn can afford to break ground on a pricey expansion regardless of resale value.

Most of us, though, should take a long hard look at our neighbors before dropping another dime on granite countertops. Comparable sales prices are a good place to get started. A local real estate agent, familiar with your neighborhood, will often perform a complimentary assessment of your home's market value. They'll also provide the all-important maximum sales price of similar homes on your block. If that figure would force you to sell at a loss, it's time to put a halt to any new construction projects you've got planned. "A Realtor can tell you what additional value would be added to your home in whatever type of remodeling you're thinking of doing and whether any improvements you might make are out of step with the neighborhood," says Paul Bishop, manager of real estate research for the National Association of Realtors.

Remember, too, that investment returns on home improvement jobs are all relative. You're least likely to recoup top dollar on a new master suite or third full bathroom if you're the only one on your block to have one. "You are usually on good ground if you are improving your home relative to other homes in your neighborhood," Baker says. "But you're on thin ice if you improve beyond the general value of your neighborhood -- like adding a third bathroom if all the other homes have two." You're also more likely to over-improve if you insist on top-of-the-line materials. Viking stoves and hand-forged copper sinks may make your dream kitchen complete, but buyers won't pay a premium for someone else's extravagance.
Generally speaking, you won't recover the full cost of any home-improvement project -- though some clearly boost value better than others. For example, you'll recover nearly 99 percent of costs on a minor kitchen remodel, 96 percent on a midrange siding replacement and 95 percent on a two-story addition, according to Remodeling Magazine's 2005 Cost vs. Value Report.

A few jobs, including an upscale siding replacement and a midrange bathroom remodel, will yield more than a 100 percent return. Jobs that add the least value: a midrange home office remodel, which recovers 73 percent of costs on the resale market, a new sunroom at 75 percent and an upscale master suite at 80 percent. Of course, homes are more than just an investment. Some of what you spend giving your house a makeover is just for you. A finished basement, for example, may not yield a lofty return, but getting the toys and board games out from under your dining room table can be worth its weight in gold for your sanity. Yet, with economists predicting slower growth ahead for the real estate market, Roll says you should carefully consider the investment return of any new remodeling job you may have planned. Improve first those things that yield the greatest return. "If you are overextending yourself, or going into extensive debt, think twice," he says, "We are seeing some slowing of home price appreciation and we're entering a period of higher interest rates. People are well-advised to be clear about what they are spending on home improvement and where that money is coming from."