

Getting Today's Best Returns from a Home Renovation

It's a much different picture renovating a home in 2007 than in 1997. Fueled by huge gains in the price of real estate, homeowners a decade ago were tapping home equity with little care since prices were expected to keep climbing, more than covering the cost of such improvements.

Today, with the slowdown in real estate and the widening damage in the subprime loan market, home prices aren't rising much – and falling in some places. And lenders tend to be a lot choosier these days about who to do business with. So before considering a home renovation, it makes sense to make sure your financial house is in order:

Start with your credit report: If you're considering borrowing, make sure your credit report and payment records are in the best possible shape. As in most economic crises, lenders go from being permissive to squeamish in an instant, so even people with good credit behavior are going to be under the microscope. Start by checking your credit report -- you have the right to get all three of your credit reports – from Experian, TransUnion and Equifax – once a year for free. You can do so by ordering them at www.annualcreditreport.com, but do so at staggered times throughout the year so you can catch potential errors in your report as they happen. Also, if you need to clean up any bad behavior – late bills, heavy credit card debt, clean it up before you wander back into the real estate market. Remember that a bad credit score can raise the total cost of your mortgage.

See what kind of payoff your chosen renovation will have: During the housing boom, people thought virtually any renovation would offer big returns. That wasn't true then, and it's particularly untrue now. Take the time to figure out what renovations have the best chance for return on investment now – go to *Remodeling* magazine's annual *Cost vs. Value* report online (<http://www.remodeling.hw.net/content/CvsV/CostvsValue-project.asp?articleID=381305§ionID=173>) and check 2006 project cost averages for your region of the country. In this market, renovate because it's going to bring you comfort or pleasure, not because you're expecting immediate profits.

Know how long you'll need to stick around: When you sell, remember that most married couples can exclude from their taxable income up to \$500,000 of gain and most individuals filing single or married filing separately can exclude up to \$250,000. It's required that you must have owned and used your home as your principal residence for two out of five years before the sale. The exclusion is generally applicable once every two years. However, if you are unable to meet the two-year ownership and use requirements because of a change in employment, health reasons or unforeseen circumstances, then your exclusion may be prorated.

Beware the bump in property taxes: The great thing about a more valuable home is the potential higher value when you sell. The bad thing is a visit from the county assessor – more valuable property tends to lead to higher tax assessments. Make sure you cannot only afford the cost of renovation, but what you'll need to pay higher taxes if your home is reassessed.

Don't forget to deduct applicable sales tax: If sales tax was imposed on a major renovation or if your state or locality imposes a general sales tax on the sale of a home or the cost of a substantial addition or major renovation, you might be able to deduct it. This alternative is particularly valuable in low-tax states, and the sales tax paid on the purchase of some large items including the purchase of a home or major addition can be added to the table amounts.

Make sure your renovation makes your home salable: A discussion with a real estate agent or someone familiar with the value of improvements in your immediate neighborhood can tell you what will add to value or take it away. For instance, a big addition can take away from the value of a home if it's not aesthetically in tune with the rest of the neighborhood. Obviously, any renovation that keeps your house on the market longer better be worth it now because it might damage your sales prospects later.

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