

Renovating Smart in 2010: Looking for Tax Breaks, Anticipating What Will Bring Value in the Future

Though the housing market has yet to stabilize in many communities, homeowners can't ignore property maintenance and other critical spending that will add to their home value in the future. Yet for most of us, the days of spending multiple thousands of dollars on a kitchen, bath or room addition expecting our market value will grow exponentially is much like the U.S. housing boom – over.

Simply put, as Americans have been forced to get more realistic about using their homes as piggy banks, it's time for similar realism about what improvements and renovations will pay off in a housing market with years of inventory to sell. Here are some steps to consider when improving your property in today's market.

Before you borrow or spend, get some advice on your overall financial picture: During the boom years of the housing market, people treated renovation as a financial fait accompli: Put in a \$40,000 kitchen and add \$60,000 to your selling price. Today, putting more money into your house requires a significant reality check. A financial planner can look at your overall savings and tax picture and give you an idea whether the dream kitchen you want is a worthwhile investment or if it's time to downsize the job to a new sink.

Check current values on the payoff your chosen renovation will have: Remodeling magazine's annual Cost vs. Value report breaks down average cost and market return for projects large and small based on your region of the country. Their website is www.remodeling.hw.net. The current 2009-2010 report reports that upscale projects like a bathroom addition returns only about 60 percent of its cost in the current market; adding an attic bedroom would return 83 percent of the cost. None of the projects in Remodeling's annual survey currently break even.

Consult Uncle Sam: The American Recovery and Reinvestment Act is still allowing taxpayers certain deductions and credits for energy-smart renovations to their property. For example, the Residential Energy Property Credit applies to taxpayers who install insulations, energy-efficient exterior windows and energy-saving heating and air conditioning with a maximum credit limit of \$1,500 for improvements put in place through the end of 2010. It's smart to consult your tax professional before going ahead on any of these moves in case Washington extends, limits or possibly increases these breaks for homeowners.

Think about how long you'll be in the home: If you want to get your money out of a renovation, keep in mind you'll probably be waiting awhile. In August, the National Association of Realtors reported a plunge in home sales after the expiration of the federal home buyer tax credit. In July, existing-home sales were down 27 percent from June and a full 25 percent below the year-ago month. Most home sales experts are not predicting full stabilization for the U.S. housing in the market for at least six months.

Beware the bump in property taxes: The great thing about a more valuable home is the potentially 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 in higher taxes if your home is reassessed. Also, keep in mind that the fall in home values hasn't led to lower taxes in many communities.

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. Discuss this with your tax professional.

Always check local valuations: A reliable and experienced local real estate broker knows what the market will bear. Talk to them about any anecdotal evidence they have about what renovations might be most sensible as your home market improves. You'll also get a tutorial on what current buyers are willing to pay for based on the current attributes of your home.

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