

Cents & Sensibility: Selling Return on Investment

Remodeling can be an excellent investment. The key to its return on investment is appreciation. The basic principle that we all know is that land and houses appreciate. Remodeled houses appreciate faster! My question to you is, "Are you consciously selling Return On Investment to your remodeling clients?"

Just the Numbers Please:

Some of you have recognized this article as the annual ROI article so all that you are looking for is the new numbers. You don't want commentary. Just the numbers. For you my friend, I will pull out my trusty Palm Pilot and share with you a thumbnail sketch of Remodeling Magazine's 2004 Cost vs. Value Report. Skip right to the table if you must, but come back to read on for insights into the customer return on investment perspective.

I keep the results of the annual report in a spreadsheet on my Palm Pilot that calculates the breakeven point for a client's potential remodeling project. It is very important to clients to know when their remodeled project will start making them money. I am using numbers in the table that have already been modified for the Grand Rapids Metro area. Remodeling Magazine's annual report gives the average cost of a given type of project (defined in their article) and the average immediate return on investment for that type of project. Let me bring this to life with an example:

A couple has a home worth \$200,000 and they do a major kitchen remodel in the mid-price range. That means it will be nice, but there's no granite or ceramic tile, and the cabinets are functional, not fancy. This kitchen's average cost in Grand Rapids is \$41,000 and has a 77.4% initial Return on Investment. The client will spend \$41,000 and their house will increase in value approximately \$31,734. By remodeling they have \$241,000 into the house, and the home is worth about \$231,734 ... for now.

In the example above, if the homeowners were to sell their home immediately after remodeling, they would lose money. This is why we say to our clients, "Don't do significant remodeling to sell your home." Most projects do not add dollar for dollar value immediately to the home. This, of course, doesn't include projects such as replacing the roof on a house or adding a nice deck that differentiates the home from other comparable dwellings without decks. However, on year two of the kitchen example, the base worth of the home has just increased and the value of the home will appreciate faster than it would without remodeling. I've heard time and time again that homes in Grand Rapids are appreciating at about 4% annually. Let's look at some numbers from our kitchen remodeling example.

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Cost vs. Value for our kitchen remodeling project example:

YEAR 1
VALUE \$231,734 < \$241,000 COST TO PURCHASE & REMODEL.

YEAR 2
 $\$231,734 \times 1.04 = \$241,003$ (BREAK EVEN IN TWO YEARS)

YEAR 3
 $\$241,003 \times 1.04 = \$250,643$ (RETURN ON INVESTMENT!)

Let's look at the example if they had chosen not to remodel the kitchen:

YEAR 1
\$200,000 X 1.04 = \$208,000

YEAR 2
\$208,000 X 1.04 = \$216,320

YEAR 3
\$216,320 X 1.04 = \$224,973

By spending \$41,000 to remodel, their home appreciated in value over \$50,000 in three years instead of the lackluster \$24,927 increase without remodeling. Because of that choice the homeowners stand to make \$25,670 off their remodeling job at resale. (\$250,6430- \$224,973 = \$25,670)

Beyond the numbers, the greatest return on investment with remodeling is that the homeowner gets to enjoy the improvements while they recoup costs within a reasonable amount of time and then gain a return on the investment they made by remodeling. There is nothing like living in a home that's been designed and remodeled to your specifications.

Limiting Factors:

Of course these calculations are nice, and I believe they are realistic hypothetical numbers. But in real life there are lots of variables. Please remember, every client's situation is unique.

The Disposable Kitchen:

In Grand Rapids, a majority of the population has more traditional tastes, which cause the lifecycle of a kitchen to be longer than a kitchen in New York City where design is much trendier. That which is hot today will most likely cool off by tomorrow. I certainly am not a nay-sayer of making a space beautiful. I'm just trying to be balanced here. Trendy design has led to a phenomenon that could be called "The Disposable Kitchen." The kitchen cabinetry industry, to some, is a fashion industry. It cycles quickly and a style may last for less than 10 years. People remodel more often because the kitchen looks dated, not because their cabinets are falling apart. The same is true of buying a new car every two years.

Value and style must be considered when remodeling because both merits are important. Homes that fit into the sweet spot of balancing value and style will have the greatest long term return on investment and stability. The core of the remodeling industry is customizing one's home to one's personal taste. Don't stifle a client's personal taste just for the sake of value unless value is more important to them than their own preference or they're making an arbitrary selection that is contrary to popular taste. I spoke with a gentleman today that said to me, "I'm not looking for my countertops to make a statement." This particular gentleman wants value over style. Above all else, help people change their homes to fit their lives. That is the core of what we do.

The Driving Force:

Remodeling offers homeowners the ability to customize their home (which is most often their single largest investment) to their own personal taste. They have the opportunity to enjoy their investment as it appreciates. You'd never use your quarterly investment statements as placemats, but you can use that new kitchen to make an excellent meal for your family and friends. Humans are tied to the space where we work and live. Remodeling makes it a space that they will enjoy using. The return on investment is quantifiable in dollars and percentages, but also in quality of life and enjoying their investment as it appreciates.

REMODELINGS MAGAZINE'S 2004 COST VS VALUE REPORT		
Top Five ROI Projects		
PROJECT TYPE	RETURN PERCENTAGE	AVERAGE COST
Reroof	109.3%	\$10,971
Deck	107.8%	\$6,657
Bath - Midscale	95.8%	\$9,002
Bath - Upscale	93.7%	\$23,753
Windows - Upscale	89%	\$14,978
Lower, but still good ROI Projects		
PROJECT TYPE	RETURN PERCENTAGE	AVERAGE COST
Basement Finish	77.8%	\$44,997
Kitchen - Midscale	77.4%	\$40,936
Family Room Addition	77.4%	\$50,700
Kitchen - Upscale	69.8%	\$71,598
Master Suite Addition	68.1%	\$127,345

Using Return On Investment calculations as a sales tool with your clients will help them justify the expense of remodeling. For more information on Remodeling Return on Investment see Remodeling Magazine's 2004 Cost Vs. Value Report. www.remodelingmagazine.com **WMRR**

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Thompson Remodeling is a Design/Build Remodeling company, serving Grand Rapids, MI for over 26 years. Patrick, my father, and I are enjoying the beginning of a May - December partnership. Home Improvement, personally & professionally, is a passion of our family. Pat, Sandie, & Ben Thompson co-host the WOOD 1300 AM Home Improvement Show Saturday Mornings 8-9am.