By Michael Berton

MOVE OR RENOVATE?

Clients do not necessarily need to leave their beloved home when their family exceeds its capacity.

Illustration by Monika Melnychuk

Mark and Samantha White (not their real names) love their suburban Vancouver neighbourhood and large corner property, but as they are expecting their third child, they have decided their two-bedroom bungalow can no longer accommodate their family.

With interest rates at historical lows and hot real estate markets everywhere, many Canadians are getting itchy feet and are looking for a bigger, better or newer home. They might also desire a shorter commute, proximity to better schools, to be closer to family or just a more prestigious address. However, when the clients love their current house, property or neighbourhood, you can expect to be asked the question: "Should I move or renovate?"

The Whites consulted with builders regarding the cost to add a 1,000 square foot second floor and reconfigure the main floor. Among other things, the newly renovated home would include an office, a home theatre room, a main-floor laundry room and hardwood floors.

The initial estimate for renovating their home was $200,000. Shocked with these costs and faced with the prospect of decamping for six months, the Whites decided to go house shopping to see if they could find a suitable home for the same overall cost.

There are a host of costs to consider when buying a new home. There would be real estate fees on selling (plus GST), legal fees, property purchase tax or land transfer tax, moving expenses, utility connection fees, and potential mortgage penalties if they have to break their current mortgage. (See "Buyer Beware," page 19.) These expenses are before they remove the ugly orange carpeting or repaint their new home.

When the Whites could not find a house that met their needs in their vicinity, they went back to the drawing board. They met with the builders again and carefully reviewed and edited several drafts of the building plans. These were circulated among family, friends and neighbours for additional suggestions. Considerable time was devoted to this stage as it would help avoid second thoughts later on. Ultimately the renovation was chosen.

While the Whites' project would expand and update their entire home, smaller well-targeted renovations can also add significant value to an existing property. According to a 1999 *Renovations and Home Value Survey* conducted by the Appraisal Institute of Canada, the following list outlines the top 10 renovation projects and their average potential payback:

- Painting and décor (interior) 73%
- Kitchen renovation 72%

Continued on page 19

Continued from page 17

- Bathroom renovation 68%
- Painting (exterior) 65%
- Flooring upgrades 62%
- Window and door replacement 57%
- Family room addition 51%
- Fireplace addition 50%
- Basement renovation 49%
- Furnace replacement 48%

The survey also suggests a few hot trends in renovations, including a main-floor laundry room, ground-floor home office, hardwood flooring in the kitchen, whirlpool bath separate from the shower, built-in kitchen appliances, the addition of a kitchen island, "smart" house wiring, a home theatre room and skylights.

Once the plans had been finalized the Whites started to discuss their construction financing needs with their lender. Most small renovations can be easily accommodated with a specially granted line of credit; however, large projects like the Whites' renovation are usually financed by "construction financing," as though they were new homes. In these cases, the bank bases their lending decision on an appraiser's valuation of the finished home. This means the bank is not specifically covering expenses for demolition, consultant's fees, permit fees or deposits, nor will they cover costs for living elsewhere.

Loaned funds are advanced only at specific points of the construction's completion (for example, at 35%, 70% and 95%). The Whites would have to cover all costs until these levels of completion were attained and then be reimbursed. This created great cash flow difficulties as many deposits and fees must be paid in advance of delivery, well before a completion target is achieved. The good news is that the new construction financing replaced the Whites' existing mortgage at a much lower

Continued on page 20

BUYER BEWARE

Don't forget these costs if your client chooses to buy a new home.

GST/HST: GST or HST is charged on new housing (but not resold housing). There is a rebate available up to 2.5% if the home costs less than $450,000.

REAL ESTATE FEES: Generally paid by the seller in a real estate transaction. The amount of the fee varies by community. GST or HST is usually charged.

APPRAISAL FEES: The lender may require a property appraisal at the buyer's expense, usually $150 to $250.

PROPERTY TAXES: Lenders may require that property tax instalments be added to payments for high-ratio mortgages.

SURVEY FEE: The lender may require an up-to-date property survey. In some circumstances, the vendor will provide this as a condition of the offer to purchase.

PROPERTY INSURANCE: The property insurance covers the replacement value of your home and contents. The lender may require this to ensure their security.

PREPAID TAXES OR UTILITY BILLS: You may be required to reimburse the vendor for a pro-rated share of prepaid taxes or utility bills.

LAND TRANSFER TAX OR PROPERTY PURCHASE TAX: Ranging from 1% to 4% of the purchase price, this tax applies to the transfer of title in most provinces.

SERVICE CHARGES: The buyer will have to pay for connection to most services and utilities (telephone, cable, gas/hydro).

LEGAL/NOTARY FEES: The buyer will require a lawyer or notary to review the "Offer to Purchase," do a title search to ensure that title is in good order and thus transferable, draw up and register the mortgage documents and attend to the closing details. This is usually at least $500.

MOVING COSTS: Fees for a professional mover can range from $50 to $100 per hour for a van and two to three movers. These costs can be 10% to 20% higher at the end of the month. Don't forget the cost of purchasing boxes or placing your belongings in storage if your moving dates don't overlap.

MORTGAGE LOAN INSURANCE PREMIUM AND APPLICATION FEE: In the case of a high ratio mortgage, the lender will require mortgage loan insurance costing between 0.5% and 3.75% of the amount of the total mortgage. In addition the application fee can range from $75 to $235.

MORTGAGE BROKER'S FEE: The buyer may be charged a fee to find a lender.

HOME INSPECTION FEE: As inspectors are unregulated in many provinces, fees can range from $150 to $350 for a home priced under $300,000. Fees for larger homes will be higher.

RENOVATION AND REPAIRS: An inspection may indicate major structural repairs such as a new roof or plumbing and electrical problems. These costs should be factored into the buyer's budget.

WATER QUANTITY AND QUALITY CERTIFICATION: The purchaser may have to pay a fee ranging from $50 to $100 to certify the quantity and quality of water from a well.

Continued from page 19

interest rate. The Whites' $140,000 mortgage at 6.25% was replaced without penalty in favour of a total of $340,000 ($140,000 plus $200,000 new financing) in construction financing at 3% for six months.

As the couple was determined to have their project finished on time and on budget, they made special efforts to be involved with the project. Samantha kept a running account of the costs and compared it to the contractor's building budget. With the agreement of the contractor, Mark was able to put in some of the unskilled labour, moving trash to the dump, hammering and pulling out nails where needed. As a result of their hands-on approach and their contractor's biweekly invoices, they were very aware of where they were financially at each step of the process.

Your clients might actually prefer to assign the entire project administration over to an architect or general contractor to distance themselves as much as possible. Nevertheless an owner will ultimately have to be called upon to make quick decisions about many of the inevitable unexpected developments that will arise.

Large projects like the Whites' renovation are usually financed by "construction financing" as though they were new homes.

In spite of the time taken to estimate costs the Whites were still surprised by a few unexpected expenses. These included many of the "pre-approval, pre-renovation" costs such as the $600 land survey the municipality required before granting a building permit, a $2,000 building permit fee and the $1,000 damage deposit to the municipality, an extra $3,000 for geo-technical consulting fees and the resulting $6,000 for drain tile and a rainwater infiltration pit. In addition, legal fees of approximately $250 had to be paid for each advance from the bank as the stages of completion were met.

Most financial planners have several clients who have experienced serious budget overruns with their renovation projects. While some overruns are natural with renovations, particularly on historic homes, this is usually the result of insufficient effort spent on planning in the first place. Homeowners should plan a contingency of at least 10% over budget if they are disciplined and have done much of the pre-shopping for things like lighting and plumbing fixtures, cabinetry and flooring, windows and doors etc. The Whites made many of these choices in advance and were able to stick to their plans and avoid the temptation to add or change items, thus saving themselves plenty of cost overruns. Without this type of preplanning you should expect your clients to exceed their budgets by much more than 10%. Some homeowners avail themselves of a renovation coach to help them stay on time and on budget.

Today the Whites live in what is essentially a completely rebuilt home on the lot they cherish in the neighbourhood they love. The project was completed on time and close to their original budget. They are very satisfied to learn that house values in their neighbourhood have been climbing and expect that their home could now fetch more than its appraised price. Most of all, the house now suits their expanded family and their lifestyle goals. **AE**

Michael Berton, CFP, R.F.P., FMA, is a financial planner with Assante Financial Management Ltd. and part-time instructor at the B.C. Institute of Technology in Vancouver. The opinions expressed are those of the author and not necessarily those of Assante or the B.C. Institute of Technology.