

# MANSION GLOBAL

## **Amid Tight Inventory and High Prices, Renovating Instead of Buying Is the Best Strategy For Some Right Now**

The calculus for renovating an existing home versus buying new has shifted rapidly

By Virginia K. Smith | Originally Published On May 6, 2022



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Since the start of the Covid-19 pandemic and the real estate market frenzy that quickly followed, one theme has been consistent: Buyers looking to move during this turbulent time have wanted turnkey properties they could hunker down in immediately.

“No one wants to do a renovation,” said Diane Ramirez, chief strategy officer for Berkshire Hathaway HomeServices New York Properties. “No one wanted to do it before [the pandemic], but now [with supply chain and labor shortages] there’s financial and timing issues, as well.”

However, two years of non-stop price increases have combined with rising mortgage rates and inflation to create a newfound sense of price sensitivity. Between the financial factors and an overall lack of quality inventory, some would-be buyers are wondering if

the cost of a brand new home is truly worth it—and if, counterintuitively, taking on renovations might wind up being less of a headache.

“There are a lot more people now that are wanting to do their own project, or more or less being forced to do their own project because of market pressures,” said Frank Nolan, president of Vanguard Properties/Luxury Portfolio International in San Francisco.

For owners who might have once considered upsizing to a new home, adding value onto their existing home may now make more financial and logistical sense.

“Many homeowners currently have quite a bit of equity they could tap into to take on a remodeling project,” said Jessica Lutz, vice president of demographics and behavioral insights at the National Association of Realtors. “They may have a significantly lower interest rate, especially if they locked in a refinance [when rates were] in the 2% range, which some did.”

According to the 2022 Remodeling Impact Report released by NAR in April, hardwood floor refinishing, new wood flooring, insulation upgrades, and conversions of basements into living areas are the interior projects for which homeowners are most likely to recover costs or even increase their home’s future resale value.

“I have clients who are considering adding an [accessory dwelling unit] onto their lot rather than selling their current home,” said Dan Ortega of Sotheby’s International Realty—Los Feliz Brokerage. “Prices and competition being what they are, it may be a better option than jumping into the bidding wars for a larger home. Especially if the current prices for a larger home exceed the cost of the renovation.”

A prime location is another factor likely to make renovation a more appealing prospect than a resale. “I find that many clients will carry out a complete rebuild of their current home, rather than move, as it’s difficult to replace a location overlooking Sydney Harbour or one of the beaches here,” said Michael Pallier, an agent with Sotheby’s International Realty in Sydney, Australia.

Daunting though a renovation or construction project might be, below are some scenarios in which it might be a better bet than buying new.

### **Record-High Price Tags on Less-Than-Stellar Inventory**

Perhaps the biggest factor driving more owners to renovate is not just the lack of available inventory, but among the small pool of properties that are for sale, a lack of quality that might justify the newly astronomical prices.

“What I’m hearing from buyers in the \$3 million to \$10 million range is, ‘I’m not going to spend money on a [new] house that I then still need to remodel,’” said Frank DeValdivielso of The Keyes Company/Luxury Portfolio International in South Florida.

“The quality of the inventory that’s available is not great, and certainly not to the satisfaction of buyers.”

“Quality is the most important thing to this type of buyer,” Mr. DeValdivielso added. “If they feel they can improve the quality of their home, even if it takes them a year and a half, they’d rather do that than go buy something that somebody else improved and flipped and it’s not the same quality.”

In markets across the U.S., the proliferation of quick flips of varying caliber has changed buyers’ perceptions of new build properties.

“There’s been a big uptick in what I call ‘developer specials,’ inexpensive townhouses in [Brooklyn] where they come in and do a quick renovation, put in central air conditioning, and flip it,” said Deborah Rieders, a New York City-based Corcoran agent. “Then the buyers move in only to discover that the HVAC wasn’t properly installed, the kitchen cabinets are cheap, the floors start popping up. Over the years I’ve discouraged buyers from buying these quick flips, because you end up renovating something you paid a premium for versus [doing the work yourself] and having an upside when you sell.”

### **Taking Taxes Into Account**

In addition to aesthetics, many homeowners might ultimately choose to renovate rather than purchase a new home for a far simpler reason: a lower tax bill.

“When you move from one property to the next [in Florida] you’re going to be taxed on the assessed value of that new property,” Mr. DeValdivielso said. “So if you spent \$2 million more on a new property, you’re going to have a \$40,000 property tax bill that you wouldn’t have if you stayed in your old property and renovated.”

In some cases, the tax benefit is so significant that buyers are willing to undertake ground-up construction projects.

“We’ve got a wave of baby boomers retiring in the next few years and planning to move to Miami, but they’re not in a rush,” said Julian Johnston, an agent with Corcoran in Miami. While a completed home on a prime lot for this type of buyer might be valued—and taxed—at \$24 million or \$25 million, Mr. Johnston said, a buyer who opted to purchase an equivalent empty lot for \$10 million and spend \$5 million on their own construction would end up with the same high value for a property for a sale in the future, but would pay far lower taxes in the interim.

“The actual retail value of the home is closer to \$24 million or \$25 million, but your taxes [for the home’s assessed value if you built] are probably based at \$12 million or \$13 million,” Mr. Johnston said.

## A Complex Cost-Benefit Analysis

After years of luxury buyers ignoring older properties, there are now deals to be had on what are often high-quality homes in prime locations, if a buyer is willing to put in the work.

In San Francisco's tight market, "I'm seeing buyers that can't afford to get into a particular location buying a house that needs a lot of work, and they're willing to put in the years and work so they can actually have the house they want in the location they want," Mr. Nolan said. "That is a direct result of escalating values."

In some cases, an older-looking home may be discounted but simply in need of a few relatively cosmetic upgrades rather than a full-scale gut renovation.

"I'm still finding that homes that need work are heavily discounted, properties that are ready to move into but not the perfect aesthetic for today's buyer," Ms. Rieders said. "I think there are incredible opportunities right now to pick up things that aren't immediately aesthetically pleasing but have a great location and great bones. Maybe the tiles and kitchen cabinets need updating but the homes are structurally solid and in great shape, and don't require a gut renovation."

Ms. Rieders added, "People can't see past the surface and instead get into crazy bidding wars on new product."

As with any major purchase or project, it's essential to go in with a clear sense of the costs and timeline. "Talk to your contractor well before you actually want to take action, and have every supply in hand so you can complete [the project without delays] once you start," Ms. Lautz said.

Especially for those weighing their options between selling or committing to updates, a project might be a significant undertaking, but given the state of the current market, "[Owners] might feel more comfortable doing work than trying to place their home on the market and playing a game of musical chairs to find the next perfect property that fits their needs," Ms. Lautz said.



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