

Chapter 1

Introduction

Have you ever dreamed of long-term financial security? Of creating a nest egg that can insulate you from financial worries and possibly free you to pursue your dreams? Well, we have, and *Renovate to Riches* is intended to be a guide to help you achieve this goal. It is a toolbox for turning your sweat (via home improvements) into equity (financial security and independence). *Renovate to Riches* is not a get-rich-quick scheme (which, as we all know, never work). It is about creating a long-term home renovation wealth creation strategy that, if properly planned and executed, is sure to increase the value of your homes and lead to significant profits. By renovating multiple homes part-time over a period of time, you can accumulate a significant net worth and invest your gains so that you begin making money in your sleep—the American dream!

To illustrate the potential of a home renovation wealth creation strategy, let's look at a five-year scenario (Table 1.1). A couple has lived in a house for 1 1/2 years but has not done any significant renovations to date. They then develop a home renovation strategy and begin renovations using the ideas from this book. They sell their house (we'll call it Home #1) in six months and one day, thereby owning the house for the minimum two years necessary in order not to owe any capital gains taxes. The couple

Table 1.1 Home Renovation Wealth Creation Potential—Five Years

	Home #1	Home #2	Home #3
Purchase price	\$225,000	\$315,000	\$380,000
Renovation costs	\$25,500	\$66,500	\$88,700
Net sales price	\$415,000	\$655,000	\$897,000
Net profit	\$164,500	\$273,500	\$428,300
Accumulated investment	(4 years)	(2 years)	
Income (@10% annual return)	\$76,344	\$57,435	\$0
Gain	\$240,844	\$330,935	\$428,300

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purchases and renovates two additional houses over a four-year (plus two-day) period. In addition, they invest their proceeds from Home #1 and Home #2 in other types of investments to diversify their portfolio. What's their total profit over five years? *More than \$1,000,000!* (Of course, they will owe capital gains taxes on the accumulated investment income derived from stocks, bonds, etc.).

We know that this is an optimistic scenario, but wouldn't you still be interested in pursuing such a path if your profits over five years were \$150,000 or \$350,000? Based upon the experience of the authors, these targets are easily within your reach.

Can This Strategy Beat the Market?

Most people who have invested in a house have beaten stock index funds and added significantly to their wealth.¹ That lesson comes from a recent examination of home prices. Whether measured over the last 10, 5, or 3 years, the simple act of buying an average home with a standard down payment led to major equity growth. Indeed, the growth was better than experienced when investing the same money in the Vanguard 500 Index Fund. That fund, in turn, did better than the average domestic equity fund—particularly after taxes are considered.

Some other compelling figures follow.

Ten Years (1991–2001)

According to the National Association of Realtors, the median home resale price in 1991 was \$97,100. A 20% down payment would have required \$19,420, and the mortgage would be \$77,680. At the end of 2001, the same home was worth \$147,500.

This means the owner's equity grew to \$69,820 in those ten years through price appreciation. (We are ignoring equity growth through amortization of the original debt.) Put that number in a financial calculator, and the 10-year annual compound growth rate is 13.7%.

The same sum invested in the Vanguard 500 Index Fund would have grown to \$60,593 over the same period, after payment of taxes on dividends and capital gains that were distributed over that time, for a compound annual return of 12.1%. Because the mutual fund investment is subject to taxes on unrealized capital gains but gains in primary residential real estate are tax free up to \$500,000, the net advantage of home ownership is even greater.

Five Years (1997–2002)

Over the five-year period 1997 to 2002, the comparison improves. Homeownership equity grew at an 18.8% annual rate, while the index fund investment grew at a 10.1% rate.

Three Years (1999–2002)

Results were better still over the three-year period 1999 to 2002. Over those three years, home equity grew at a 20.5% annual rate, while the index fund investment lost 1.5% a year. If you had bought the median-priced home for \$128,400 with a 20% down payment of \$25,680 and a mortgage of \$102,720 in 1999, you would own a home worth \$147,500 in 2002. Your equity would be \$44,780, an increase of \$19,100.

Because the Vanguard 500 Index Fund did better than most managed equity funds over all three periods—both before and after taxes—we can safely say that the vast majority of people who became homeowners over the last 10 years have done better in their real estate investing than in their financial asset investing. This is important. You can get some idea of *how* important by considering the distribution of net worth. As recently as the 1998 Survey of Consumer Finances, the median net worth of all U.S. households was \$71,600.² That's only a tad over the \$69,820 of equity built by the 10-year homeowner.

In other words, a single investment decision—to buy a home—was enough to take a family into the midrange of U.S. wealth. Add a steady job, modest annual savings, and a typical employer match for a 401(k) plan, and anyone who could balance a checkbook could have vaulted into the top half of all wealth holders over that 10-year period.

Are you interested in generating a possible 50% return on your investment—not even counting the tax break you'll be receiving on your federal taxes via the mortgage tax deduction, plus the fact that if you keep your home for more than two years you will pay no capital gains taxes on your profits? If you answered yes to this question, take the following Home Renovator IQ Test. If you answered no, please give this book to someone you know who is interested in creating significant tax-free wealth.

What is the Home Renovator IQ Test? It is an assessment of your knowledge, skills, and abilities (KSAs) to be a successful home renovator. Your score can range between 15 and 75. If you score high on this test (between 55 and 75), you're ready to begin tackling a home renovation today on your own. If you score in the middle of the range (35–54), you may need ongoing help and guidance from a general contractor or construction professional, especially on your first home renovation. And if you score low on this test (15–34), you may need to create a personal development plan to acquire some of the KSAs necessary to be a successful home renovator.

Home Renovator IQ Test

On a scale of 1 to 5, with 1 = No, 3 = Maybe, and 5 = Yes, please rate yourself on the following statements:

1. Are you interested in attaining financial security and independence?
2. Are you a “hands on” person?

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3. Do you possess some basic skills related to fixing up a home (painting, building a deck, installing electrical wiring, etc.)?
4. Are you interested in acquiring greater KSAs in the area of home renovation?
5. Can you live in a construction zone?
6. Are you a good project manager?
7. Are you a good problem solver?
8. Are you good at managing money and budgets?
9. Are you a good negotiator?
10. Are you comfortable with taking some limited financial risks?
11. Do you have time (such as weekends, evenings) to devote to looking at (and re-searching) homes on the market, accomplishing home renovations, managing contractors, and so forth?
12. Can you spot a good home bargain?
13. Do you like to look at magazines such as *House & Garden*, *Coastal Living*, *Elle Decor*, *Metropolitan Home*, *Country Living*, and *House Beautiful*?
14. Do you like to watch home improvement television programs offered by the House & Garden Channel, *This Old House*, the Gardening Channel, and so forth?
15. Do you have the financial resources to purchase a home and pay for subsequent home renovations?

Renovate to Riches covers all of the steps necessary for you to develop and execute a wealth creation strategy based upon buying, fixing up, and selling your primary home (i.e., the one you live in full time). In the following chapters, we will:

- Provide practical guidance and tools for developing a long-term home renovation strategy that is sure to produce significant profits.
- Cover the federal tax law and code that makes this form of profit (i.e., capital gains) tax-free.
- Help you create a financial plan for creating significant wealth over a 5-, 10-, or 20-year period.
- Provide practical advice on buying a home for well below the asking price and selling it for a high price (maybe even more than your asking price!).
- Discuss the intricacies of financing a home purchase.
- Describe the renovations that can add the most value to a home and offer guidance on interior design, landscape architecture/landscaping, and creating “curb appeal.”
- Offer advice on the types of projects to tackle yourself and those that are best left to professionals.

- Provide help on how to effectively work with contractors (they can be your friends!).
- Summarize the practical advice and guidance we received from interviewing dozens of experts that you'll encounter during your home renovation journey (real estate agents, mortgage brokers and bankers, general contractors and carpenters, landscape architects, interior designers, home inspectors and appraisers, etc.).

We will also describe in detail our own home renovations (a condominium in Washington, D.C., a historic farmhouse in West Virginia, and a wine-country home in Sonoma, California) and provide brief case studies from other people that have been bitten by the home renovation bug. These examples will describe various home renovation strategies and the lessons learned from these experiences. You'll see that we've made countless mistakes. We hope that by reading this book, you'll make fewer than we did.

One final point. We have a strong belief that anyone can learn some basic home renovation skills (e.g., painting, demolition, landscaping, etc.) and do a portion of the work themselves (see Chapter 8). Obviously, this sweat equity can add up quickly and put real dollars into your pocket once you sell your home. For example, at our Sonoma house, we got quotes for putting in hardwood floors that averaged about \$13,000. We decided to lay the floors ourselves, and although we had never done this before, we completed the job in four days for less than \$3,000. It was extremely easy to do once we read a few floor installation guides, got the necessary tools, and talked with our general contractor, who gave us some excellent tips. So we added at least \$13,000 in value to the house for less than \$3,000—a savings of more than \$10,000 (money in our pocket once we sell the house).

Best of luck on your home renovation journey!

Denise Milito and Dave Stockwell, Home Renovators

How Did We Find It? Word of Mouth

Frustrated by the sight of many condos available in our price range, we started to look at streets that appealed to us within our price range. We had always liked Glenwood Avenue, a nice, quiet street lined with trees and multifamily units sporting flower boxes. It's nestled away two and a half blocks west of Lake Michigan in a small area of Chicago known as Rogers Park. We finally asked a friend on Glen-

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wood if she knew of anyone looking to sell. Within two days, we had the phone number of a person who needed to sell. Within two weeks of our first phone call, we had a signed contract, \$5,000 below our budget limit. It was too easy. The hitch—it was a mess. Inside were pink walls with salmon trim embossed with a bold layer of nicotine stain. It looked as bad as it smelled, but we could see the potential. The condo association took great care of the common elements, and our unit had a new deck off the back. The unit is 1,650 square feet and has two bedrooms, a den, one bathroom, a kitchen, and a large living room with a bay window.

Closing date: October 15, 2000.

Purchase price: \$106,500.

Appraisal 2003: \$240,000.

Approximate cost of renovation: \$25,000.

List of Repairs/Renovations

New kitchen (all new appliances, cabinets, and floors).

New bathroom (new fixtures and floor).

Plumbing in bath and kitchen redone.

New lighting fixtures installed in all rooms.

New electrical outlets and outlet covers installed.

Floors resanded and sealed.

All walls patched and repainted, including new plasterwork in dining room.

Wallpaper in den removed.

Dummy space in kitchen removed and new wall built to gain space.

Window buried in wall exposed to allow more light in kitchen.

Plaster removed from one wall in front bedroom to expose brick.

Existing bathroom window replaced with glass block.

Where to Start?

First, we tore out the existing elements in the bathroom and kitchen, in a complete gut and removal, followed by the wall removal in the front bedroom.

Every wall in every room was washed, patched, and painted.

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Next, we laid a custom mosaic-tile floor in the bathroom—80 hours of hard labor, but the result was great (more detail follows).

We hired someone to sand the floors because we had no experience and it is a dirty job. We opted to seal the floors ourselves to save \$400. This worked out well, although in retrospect it could have used a few extra coats. We followed directions, but we both think two more coats would have done the trick.

Bathroom

We removed one complete wall of tile, took everything down to the studs, took off one layer of flooring, and left the bottom layer for a base.

I designed and installed a custom mosaic-tile floor with my friend Caryn Mitchell and paid only \$1,500, including the cost of materials and her fee. Installing the floor took 80 hours, and it is valued at \$10,000. We saved a ton by doing a lot of the work. It laid a great foundation for the room and is the show-piece of the house (see Figure 1.1 for a photo of the mosaic floor and the bathroom during renovation; Figure 1.2 shows the completed bathroom).

My (Denise's) brother did the plumbing, installing all new copper pipes and reconfiguring the pipes in the bathroom and kitchen. This improved the water flow. A wall was built at the end of the tub to accommodate the pipes that originally were on the outside wall. (Not a good placement for Chicago!)

Dave dry-walled, puttied, and painted the walls and ceiling. We installed a glass-block window, tile, toilet, and sink. We echoed the mosaic floor pattern in an all-white mosaic around the top of the shower area and finished off the windowsill with the same pattern as the floor. A neutral sage/cool blue paint on the walls sets off the colors of the floor. The trim is all white, as is the tile. We saved a bunch of money by handling the entire renovation on the bathroom. We kept the vintage tub and had it resurfaced. Its shape and depth make it much nicer than the new ones on the market.

Costs:

- Toilet, sink, and faucets: \$1,500.
- Floor: \$1,500.
- Window: \$150.
- Materials: \$1,000.
- Lights: \$150.

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Figure 1.1 Mosaic floor tile detail (and the happy renovators!)



Figure 1.2 The completed bathroom

- Tub resurfacing: \$300.
- Trim-work contractor: \$500.
- Total: \$5,100.00.

Kitchen

We ordered all our cabinets from IKEA, and because we assembled them ourselves we saved a lot of money. See Figure 1.3 to see what the kitchen looked like prior to our renovation. We spent about \$2,800 on the cabinets and also installed them ourselves with the help of a friend. We hired a contractor to help speed up the process in the kitchen. He rebuilt the wall we had removed, installed the window, puttied, and painted. We decided on a Pergo floor because of its simple design, a natural stone finish. It works well with the cabinet colors. A solid black granite

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Figure 1.3 Kitchen before renovation



Figure 1.4 Kitchen after renovation

on the counter looks clean and sharp. We bought stainless-steel appliances—Kenmore Elite, nice, and not too pricey. By shopping at Sears we also got one year's free financing. This detail helped us finance the project over time. Figure 1.4 is a photo of our kitchen after the renovation.

Costs

- Cabinets: \$2,800.
- Window (installed): \$250.
- Free-standing chopping block: \$900.
- Granite counters: \$1,600.
- Appliances: \$3,800.

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- Floor: \$600.
- Contractor: \$1,000.
- Materials: \$700.
- Sink: \$300.
- Miscellaneous: \$300.
- Total: \$12,250.

First finished: Bathroom

Last finished: Kitchen

Timetable: Started in October 2000, finished in December 2001.

Living Room

Painted walls and trim.

Sanded and sealed floors.

Stripped white paint from fireplace brick.

Created mosaic in fireplace using stone from the beach, recycled tile, and natural rocks.

Installed a gas fireplace unit.

Installed lights above shelves surrounding the fireplace.

New ceiling and wall light fixtures installed.

Front Bedroom

Sanded and sealed floors.

Exposed, cleaned, and sealed brick wall.

Extended walls and ceiling to meet the brick.

Installed new crown molding.

Painted.

Installed new ceiling lighting fixture.

Dining Room

Replastered walls.

Painted molding.

Painted walls and ceiling.

Installed new ceiling lighting fixture.

Sanded and sealed floors.

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Back Bedroom

Repaired and painted walls, ceiling, and trim.
Replaced lighting fixture with halogen track lighting.
Sanded and sealed floors.
Installed new electrical outlets and light switches.

Den

Removed wallpaper.
Repaired walls and painted ceiling, walls, and trim.
Sanded and sealed floors.
Installed new electrical outlets and light switches.

Biggest Problems

The biggest problem was finding reliable help. I do not recommend using friends because you move to the bottom of their priority list. Next, we moved very quickly and got a bit burned out. Finally, older homes have bad plumbing and electrical wiring. You need experts to correct these problems.

Best Assets

A strong vision goes along way. This place was the pits, but we recognized the value of its size, layout, and beautiful trim. It had a lot of potential but bringing it out required a lot of time, talent, money, and dedication.

Best Advice

Look through design books to get some ideas of what you like, then be creative.

How-to books are very helpful, and I used them to lay the tile in the bathroom. I was really nervous to start, but I felt like a pro by the time I finished. I only wish I had laid the tiles closer together. The spacers you can purchase give almost too much space.

Use good materials because every penny well spent will be regained in future appraisals.

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Only contract out what you cannot do yourself. Having an expert do the work you can't saves your energy, and you'll get excited when you see an aspect to the job move forward without your having to do it yourself.

Finally, details make all the difference!

Must-Have Tools

- Good-quality cordless drill.
- Electrical meter.
- Miter saw.
- Reciprocating saw—it cuts anything, so it is very versatile.

Notes

1. National Association of Realtors, Morningstar Principia Pro, December 31, 2001, data; (a) assumes 20% down payment on national median-priced home, (b) assumes reduction for income taxes on dividend and capital gains distributions during period.

2. 1998 Survey of Consumer Finances, U.S. Federal Reserve Board, *Federal Reserve Bulletin* 86 (January 2000).