

## COVER STORY

# Dollars and sense

Putting too much into your house can backfire, advises **David Adams.**

**A**T ONE extreme, the top end, it's not that hard to spot a house that's been overcapitalised. Towering over the neighbours, it's the sort that has everything money can buy — a home theatre, swimming pool, tennis court perhaps, and fittings and fixtures that would befit a palace — and looks dramatically out of step with surrounding properties.

Take it down a few notches and overcapitalising — when you improve or build a property to the extent you won't get your money back when it's time to sell — is a common enough pitfall among people building a new house or renovating. Although you may choose to do so for lifestyle reasons, for people wanting a quick sale it may mean a house languishing on the market for months without a bite.

Do your homework and it's a trap to avoid.

Melbourne buyer's advocate Peter Rogozik describes



Even the wealthy can overcapitalise. This US Tuscan-style house had to drop \$A3.27 million to about \$US19 million to attract buyers.

overcapitalisation as “one of the most common real estate sins” but says it is avoided by paying attention to a suburb's median price — the middle figure at which houses sell. He draws on the analogy of a pyramid: “The

base of the pyramid is where the median price is and that's where the largest pool of buyers are,” he says. “But as you go up that pyramid there's a smaller pool of buyers. So, really, when you're looking to renovate or improve your property, you've got to look at where that median price is and you don't want to go too far above it.”

This means that property worth more than \$1 million in Yarraville, for example, where the median price was \$537,500 in the December quarter last year, on Real Estate Institute of Victoria figures, may take much longer to sell than a house of similar value in say, Brighton East, where the median price was \$1.06 million in the same period.

Mr Rogozik says that while it's fine to improve a property to a value well beyond a median price, if it is done purely for lifestyle reasons and the owners intend living there “for 30 years”, those looking for a short-term return are wise to be cautious.

Overcapitalisation, he says, could mean a property sits on the market for a long time before selling. For vendors who are under pressure to sell, this can mean problems.

“Eventually you may have to accept a lot less than what you really want and at the end of the day you'll make a loss. That's what happens with overcapitalisation. If people do have to sell in the short term, they lose money.”

## Over or under? Caution costs plenty

An allied problem to overcapitalising is undercapitalising. That is, spending too little on a property and not maximising returns when it comes time for sale and, say real estate experts, it's more common than you might think.

“You see this often, actually — probably just as much if not more than overcapitalisation,” says buyer's advocate Peter Rogozik.

“(It's when people) have got a good location, they've got a good street and they've got a good suburb and they do a renovation but it's just a cheap renovation and it looks cheap. What happens in that situation is the buyers walk in and they've got the money and they see cheap taps, cheap light fittings and they walk straight out. So undercapitalisation is also a trap to fall into.”



Overcapitalisation occurs in many ways: installing a swimming pool in an area where not many houses have them, adding fixtures and fittings that are out of step with surrounding houses, expensive home theatre or sound systems or over-the-top landscaping with water features.

Cameron Fisher, managing director of real estate firm Changing Places, which has sold properties in more than 200 suburbs in Melbourne, says that one of the most common ways people overcapitalise is by creating too big a property on too small a parcel of land.

"Effectively they might be adding more bedrooms — turning a two-bedroom home into a four-bedroom home — but only having a handkerchief (sized) back garden means that they've created a family home but not on a family-sized block," he says.

Mr Fisher says that one of the ways to avoid overcapitalisation is by checking out prices for their style of property in the area.

"People have got to make sure they're not putting their single-fronted home into a double-fronted price category," he says. "Specifically, look at what's the highest level the market can take for that style of home. So you need to do your homework."

He adds that the location of some properties means they are more susceptible than others, given the effect that location can have on price.

"Where you can particularly overcapitalise is on main roads, next to train lines, next to housing commission flats," he says. "In a boom market, a lot of buyers don't differentiate so much between side streets and main roads but when a market turns — as it looks like it's starting to — you're going to find people will differentiate very quickly and it's those properties that will be hardest hit."

Real estate agents generally agree that the market outlook —

## Capital ideas



Ensure fittings are appropriate to the property.

### How to avoid overcapitalising:

■ **Do your research before starting a renovation. Check median prices in the area and the highest and lowest ranges. Find out what similar properties sell for in your area.**

■ **Think about how long you will live in the property after a renovation — overcapitalisation is most often a problem when looking for a quick sale.**

■ **If renovating in a less than desirable location, such as on a main road or by a railway line, be aware that these properties**

**may be more affected by overcapitalisation issues in a slower market.**

■ **Beware of overdeveloping the block. A family house is less attractive if it has no backyard.**

■ **Ensure fixtures and fittings are in keeping with the rest of the property and, if installing extra features such as a swimming pool, explore whether other houses in the area have one.**

■ **Seek advice from industry professionals on how much to spend on a renovation.**

a pulling back from the rapid price rises that have been seen over the past couple of years — means they would expect to soon see more evidence of overcapitalisation.

"It will become more and more common," says Mr Fisher. "It's not so common at the moment because the market has

looked after everybody."

It's interesting to note that although overcapitalisation may not be as common in a strong market, improving a property beyond what the market generally allows leads to smaller profits.

Angie Zigomanis, senior consultant at BIS Shrapnel,

explains: "Say you buy an older house for \$400,000; a year later you might sell it for \$500,000. But say you've spent another \$100,000 on it in improvements so the cost is \$500,000. Maybe you sell it for \$550,000 — so it looks like you've made \$150,000 profit on the first price but technically you could have made more by not doing anything."

Overcapitalisation is generally more likely to be seen in areas where values aren't growing at such a rapid rate or in areas where median prices are generally at the lower end of the market, meaning that the cost of extensions or improvements equates to a greater proportion of the total cost of a property than in high-value areas.

While such areas can include outer suburbs such as Avondale Heights and Epping, overcapitalisation also happens at the top end.

South Yarra real estate agent Philippe Batters says he sees quite a bit of overcapitalisation at the market's upper end but notes that with such properties "you're dealing with very wealthy people who want what they want".

"They take the attitude that you've got the biblical three score years and 10, or hopefully more, on the planet and if you've been very successful, it's only a tiny percentage of your estate that otherwise would go to the kids or the lost dogs' home or whatever."

But Mr Batters is quick to add that given the rapid capital growth of high-end suburbs such as South Yarra, "time takes care" of many overcapitalisation issues. "The only exception being when somebody has had a taste bypass on what they've done," he says. "(But) we see only very small evidence of that."

Serial renovators can also be in trouble through overcapitalisation. But the renovate-and-sell brigade "has dried up a lot because of the cost of trades to renovate the property", he said.