

Case Study - Home Value vs Lot Value in Metro Houston

It is fairly common knowledge that if you keep up with home product replacements and home improvements such as a new roof and painting your home when needed, you will optimize your home's value when you sell. It is also commonly understood that certain types of remodeling projects can also increase your home's return on investment better then others. The best financially performing renovation projects are kitchen remodels, bathroom remodels, a new roof and new windows.

These types of generally accepted remodeling practices are very good rules of thumb but do not always apply as the best performing home remodeling solutions for older period luxury homes in metro Houston. Period vintage Houston homes are often in a class of their own. They have special economic factors that newer homes in outlying areas are not exposed too. We will examine these factors and discuss some special remodeling projects that can optimize and increase your older home's ROI.

We will restrict this discussion to metro Houston and close in neighborhoods, where it is common to find homes build before 1970 on lot sizes larger than 6,000 sf. These home's architectural styles are fairly consistent with the decade they were built. You can expect to find the majority of the architectural styles represented by traditional two story homes from the 1920 - 1940 periods and single story ranch and bungalows from the 1950 - 1960 periods.

Lot Size / Home Size Ratio's

As anyone that travels around the central Houston area has noticed, there are many homes being build where older existing homes once stood. In many cases when the deed restrictions will allow, there are multiple homes being constructed on a single lot that once only had one home. You are also likely to notice that that the majority of these new homes are 3 to 5 stories tall. This is due to the price increases of land over time.

Urban land values have steadily increased in price over the years outpacing the value of the unmaintained and ruinous homes that were once located there. Developers and home builders buy the land and subdivide the lot to put multiple homes on the property. This is economically significant because it illustrates a changing dynamic in home ownership on medium to large size lots.



Let's take a modest vintage home in a nice upscale metro Houston area. It is a 2 story home about 2,000 sf living area on a 8,000 sf lot. The value of this home is \$1,000,000 and it has been well maintained over the years. One look at the appraisal districts value assessment will immediately send off a few red flags. The appraisal district has the home valued at \$800,000 for the land and \$200,000 for the home. This home could never be replaced for \$100/sf. Although there is a case to be made on the behalf of the appraisal districts valuation, this property has fallen victim to the land value dynamics of land prices outpacing home values.

There are 2 value increasing strategies that can be applied to this property. The first is obvious, sell the property for land value. The owner will not receive top dollar but can comfortably receive their equity and not spend any additional capital on this home. The buyer is likely to tear down the property and build a much larger home that resolves the imbalance issue of lot to home value relationship.

The second value increasing strategy is to increase the overall size of the home. This can be accomplished by adding a room addition or in this case a home addition. We will explain this more further on in this article. When you add an home addition the unit home price decreases, while the overall property price/value increases. This effect causes the home's unit price (Market Value / Living Square Foot) to adjust in line with the average value prices of the neighborhood.

This value effect is due to a natural economic factor of home size to lot size. As the building lot value increases in price so must the size of the home in order to uniformly increase in market value. If the home does not increase in size as the price of land increases, the house will ultimately become economically obsolete or irrelevant.

So what do you do if you are faced with this dilemma? This is a challenging situation to face and the solution is a complex matrix of possible scenarios. It starts with understanding your financial position. How much equity is built up in the property and what is your ability to afford a larger house payment. We will assume for this article that you have equity and you are evaluating what options you have. It also has to do with the emotional investment you have in the home and neighborhood. It is not always easy replacing a home or a neighborhood you enjoy.



Expanding the Homes Living Area

There are a number of strategies to employee in expanding the living area of a home. There are also various cost associated with the different strategies in expanding the home. The most cost effective method of expanding the living area of a home is to repurpose non air conditioned space to living area. Under roof areas of porches, garages and attic space are good candidates for this type of remodeling project. With the cost of the structure already capitalized, the cost of building out these types of spaces is dependent upon the finishes you choose to use.

The second most cost effective home expanding strategy is referred to as a room bump out. This is when you design a room expansion that actually bumps out a portion of the home's envelope without actually building an room addition. An example of this would be a room that might require an additional 3ft to 5ft for storage or better accessibility to other rooms. The cost of this strategy varies and is dependent upon many factors. The expense of a bump out on a wood subfloor is more cost effective then one that requires expanding the concrete foundation.

The third living room expansion strategy is adding a room or home addition. This is the strategy that most people use when attempting to add a large meaningful space to the existing home. There are many factors to consider when evaluating expanding your home through a home addition strategy. The designer must first consider the structural impact of attaching an additional structure to the existing envelope. There are some major concerns to attend to like attaching rooflines and mechanically attaching the foundation.

One of the complications that arises in designing the home addition is when you are required to reroute utilities that are in the path of construction. This includes yard lines and overhead lines that attach to the home. A great deal of planning and coordination is required to reroute utilities that could become a major disruption to the owners if not executed properly.

The cost of a room addition or home addition will vary greatly with the required needs of the design plan. The cost to expand a kitchen or bathroom is triple the cost of adding a bedroom or family room. There are many other major factors that affect the total cost of an home addition. Some of these evaluations involve determining the need for additional air conditioning capacity, new electrical demands that could require upgrading the electrical panel service and the adding of new plumbing needs.



Tear Down the Existing House and Build a New Home

The greatest market value of a metro Houston home is the location and land that it is built on. If you have been in your home for a number of years and have found yourself in the imbalanced lot to home value ratio dilemma, you actually have 2 additional strategies available instead of home additions. The first is an outright sale of the property on the open market. In the example we used earlier it is possible to obtain the going market price for your property. Depending on the current demand conditions of the housing market will dictate if you realize a price above or below the market.

The second strategy associated with leveraging the land value of your property is to design a new home for the existing lot. There are a number of advantages to this strategy that outweigh the disadvantage. The disadvantage is that you will likely spend a great deal more money building a new custom home on your lot then you would remodeling the existing home. Although the actual market value will be 20% - 30% greater when you build a new home over an equally impressive home renovation.

The advantages of building a new home on your existing lot are numerous. First you can live in the existing home during the early planning and design phase of the new home building process. Although you will be required to find temporary housing from demolition through the end of construction phases. This allows you to enjoy the process more when you do not feel the urgency to complete all of the required task associated with design and product selection on someone else's schedule.

Secondly and most importantly, there is a substantial financial gain that occurs when you build on a lot you already own. A homeowner in metro Houston will usually experience substantial equity build up in the value of their property from price appreciation overtime. These capital gains are in affect lost during a transaction that involves the selling of your property and the purchase of a new property. This means that the capital appreciation gains you experienced in your existing home are nullified by the same capital appreciation that the home you are purchasing experienced through the same period.

In addition, you will experience further transactional expenses associated with the sale of your property in the form of sale commissions, closing cost and finance cost. When you elect to build a new home on your lot you will save the expenses of (8% -9%) the sales price and experience a cost savings from eliminating the lost transfer value of the capital appreciation you have earned. Depending on how long you have lived there and the developments in the local economy during that period will determine the value of your value appreciation. According to the HAR (Houston Association of Realtors), West



University which we used in our example has seen price appreciation in the range of 30% the past 5 years. That represents nearly a grand total of 40% of the estimated market value of the property. In our example that equates to about \$400,000 in gains that do not get forfeited due to buying a new property.

Lastly, you are able to maintain your relationship with your neighborhood and not to be forced to develop new routines for shopping and dining needs. By electing to build a new home or to remodel your existing home, you will obtain all your earned equity made on your property and can enjoy watching it grow at even a greater rate of return.