



Over Capitalizing: What it is and how to avoid it

As a home owner or property investor, you may have heard the term ‘overcapitalizing’. But what exactly is it and why is it considered bad?

While adding a new deck or kitchen can increase the value and enjoyment of your property, overcapitalizing can end up costing you more than you planned. Here’s a closer look at what overcapitalization is, why it’s bad, and how you can avoid it and still increase the value of your property.

What is overcapitalizing?

Simply put, overcapitalization is when the cost of a home improvement is more than the value it adds to your property.

For example, if you buy a property for \$500,000 and spend \$100,000 on a new outdoor kitchen area with timber decking and fancy landscaping, it doesn’t automatically increase the property’s value to \$600,000. If similar properties in your neighborhood are selling for a maximum of \$525,000, your eye-popping improvements are unlikely to increase the selling price beyond this – meaning you have overcapitalized.

Why should overcapitalization be avoided?

Aussies love investing in their homes. However, keep in mind that while certain renovations can increase the value of your home, there is an upper limit on what properties are worth at any given time. If you find yourself in a situation where you have to sell an overcapitalized property on short notice, you could find yourself losing out on your investment.

Increase the value of your property without overcapitalizing

While overcapitalizing is never a good idea, there's no question that the right renovations can significantly add value to a property.

Some areas where home improvements can make a big difference include:

- new curtains or blinds
- a fresh coat of paint inside and out
- updating light fittings with modern fixtures
- renovating an old kitchen or bathroom
- refinishing floors and replacing carpets
- adding a carport or garage.

When it comes to renovations, the key is to increase the kerb appeal without exceeding your budget. Consider your neighborhood and the types of features that buyers or renters are likely to be looking for, and be willing to set your personal preferences aside. While you may enjoy having a beautifully landscaped yard or pool, the next person living in the house may not. In other words, it pays to be practical.

A good rule of them

In general terms, you'll probably avoid overcapitalizing if you keep the cost of your renovations to less than 10% of the value of your home. The less you need to invest in your home to give it that wow factor, the more you can expect to get back when it's time to sell. And always keep a close eye on the sale price of similar properties in your area.

With many people continuing to depend on property investments to meet their financial goals, it's important to make sure you have the right information and tools on your side. Talk to your mortgage broker about how to unlock the full potential of your home or investment property with a renovation.