Remodeling Best ways to pay for it now

If you're planning to borrow against the value of your home to finance a major remodeling project anytime soon, you might be in for a shock. Even if you have a stellar credit record, you could face far more scrutiny than you would have in years past, especially if you live where home prices are falling.

The reasons? Declining home values and troubles in the nation's subprime mortgage market. In the past year, as adjustable mortgage rates have risen, more overstretched borrowers have seen their homes forced into foreclosure. Some lenders have responded by tightening their standards for all borrowers, from the least creditworthy to the most.

A couple of years ago, it wasn't all that unusual to borrow, say, 90 percent of your home equity for a large renovation, notes Charles DiPino, president of the Maryland Association of Mortgage Brokers, who has been in the mortgage business for 15 years. "When values were rising at 15 to 20 percent a year, it was no problem," he says. "Now that we're in a flat or declining real-estate market, lenders won't assume the same risk."

With home prices dropping, a lender might also be more strict when evaluating your home's market value, says Michael Knight, CEO of Vanguard Mortgage and Title in Littleton, Colo., which owns mortgage companies in 18 states. Before granting you a loan, some lenders will now ask for a second appraisal. "We're seeing an extremely tight environment in appraisals," Knight says. "They're questioning the value of the home and also the credit score of the borrower."

Weakening home prices might also make you want to reconsider the scope of your remodeling. Because many projects fail to recoup their costs even in a rising market, it makes little sense to remodel in hopes of boosting a home's value. The best reason is to make the home more livable and enjoyable for your family.

That said, bankers and brokers insist there's still plenty of competition for creditworthy borrowers, especially if you've built up a significant amount of equity in your home. And the rates on loans, while rising, remain historically low.

LAND THE RIGHT LOAN

If you decide to go loan shopping in today's tougher marketplace, these will be some of your borrowing options:

Home-equity line of credit (HELOC). This type of financing is best if you plan to do several projects over a number of

years. As with a credit card, you borrow only what you want to, making interest and principal payments once you start accumulating a balance. The interest rate is variable and generally based on the prime rate plus a quarter to a half of a percentage point. Interest payments on home-equity loans and mortgages totaling up to $1 million are tax-deductible if the debt is used to buy, build, or improve a principal residence or second home. According to HSH Associates, a publisher of financial information, the average closing fee charged for HELOCs is about $50. Some lenders also make you pay a maintenance fee, typically about $50 a year, if you don't keep an outstanding balance. Those credit lines typically remain open for 10 years.

Home-equity loan. This is generally your best loan option for a one-time remodeling project. Like the HELOC, this loan is secured by your home's equity. However, the amount you borrow and the interest rate you'll pay are fixed at the outset. You might have to pay closing costs, which collectively can run $1,000 or so. Home-equity loans typically last from 5 to

Finance it yourself?

If you have ample savings and are willing to use it to finance your remodeling project, you can avoid borrowing altogether, of course. Most CR readers, according to our surveys, do just that.

But before you write any checks, you might want to weigh the opportunity cost. That is, how much could your money earn if you kept it invested and simply borrowed to cover the project?

A safe, five-year bank CD would earn you about 5 percent now, compared with the 8 percent or so you'd pay to borrow against your home equity. In that example, paying cash is probably smarter than borrowing.

If, however, you could earn more than 8 percent on your money, borrowing starts to look more attractive. For example, Vanguard's 500 Index Fund, which invests in stocks, has returned an average of 8.4 percent a year since 2002.

When you factor taxes into the equation, borrowing looks even better. If you're in the 28 percent tax bracket and itemize, an 8 percent home-equity loan costs you only about 5.75 percent after you deduct the interest. Meanwhile, capital gains taxes would take a bite out of that 8.4 percent stock return, but you'd still get to keep about 7 percent.

Bear in mind, however, that borrowing, unlike using cash, puts your home at risk if you can't repay.

ILLUSTRATION BY BOB ECKSTEIN

local independent stores. This was lower than the 10 percent for contractors from Home Depot and 15 percent from Lowe's. What's more, designers and architects hired by our readers also offered better design help than those from home centers and manufacturer stores.

Company stores stay on schedule. Going directly to the manufacturer can pay off, whether you use a store such as Pella Windows and Doors or use a contractor specifically recommended by a manufacturer. Those who did reported relatively few problems with workers. Those contractors were also best at sticking to a timetable, perhaps because of their greater familiarity with the products. Their design services rated better than Home Depot but no better than Lowe's.

Lowe's and Home Depot are similar. Both stores recommend contractors from a centrally vetted, hired, and controlled pool of installers typically assigned to a specific region. Company inspectors periodically monitor their work, particularly if a customer has complained on a survey or called the 800 number, which bypasses the store. But there's roughly one inspector for every store or two.

CLOSE ATTENTION IS KEY

Keep your remodeling project on track and within budget with these tips:

Do your homework. When asked what they would have done differently, respondents most often said they would have done more research beforehand, chosen their contractor more carefully, or bought different materials.

To avoid those regrets, get at least three bids with three or more references from each, and interview or visit references before signing. Never jump for the cheapest bid. And with any quote, read the contract carefully, especially any fine print. Home Depot and Lowe's, for example, demand full payment up front unless state laws forbid it.

Keep a lid on costs. Staying within budget seemed to be a common complaint across the board. Both Home Depot and Lowe's say they calculate some installation costs to offer preset prices and stick to them unless something happens that's outside their control—for instance, should the contractor discover termite damage, leaking pipes, or dry rot once a wall is opened up. For other installations, such as cabinets, they require an on-site visit before giving a price—with the same provision for unexpected conditions. Nevertheless, only about 45 percent of respondents said contractors from home centers were excellent at keeping costs down vs. about 55 percent for the rest.

Expect surprises. No matter whom you hire, unavoidable surprises can still happen once contractors see what's behind or beneath whatever they need to remove. So be sure your contract includes provision for a "change order" clause—an addendum that specifically details what kind of changes require your approval before they can be made. That agreement should state how the extra work would affect overall costs and the finish date.

The National Association of the Remodeling Industry suggests you put 10 percent to 20 percent of total funds into a reserve fund for unanticipated costs—at the very least, for redecorating afterward. And don't create surprise expenses. Settle early on what you want, and stick to it.

Stay involved and available. Many readers felt they weren't kept in the loop about the job's progress. To keep that from happening to you, set a specific time each day to speak with your crew's supervisor. Be sure that you have his cell-phone number and that he has yours. Inspect the day's work every evening. Mention concerns immediately to help keep problems small and resolvable. The longer you wait, the more difficult and expensive the problem can become to fix.

Ratings contractors

In order of overall reader score.

Who provided installation	Reader score (0–100)	Excellence of service: Workmanship	Promptness and speed	Keeping you informed	Keeping costs down	Problems: % with any problems	Items damaged or installed incorrectly	Problems not resolved	Took too long
Contractor employed or recommended by a local independent store	87	+++	+++	+++	++	28			
Contractor chosen by reader	86	+++	++	+++	++	29			
Contractor employed or recommended by manufacturer of material	86	+++	+++	+++	++	28			
Contractor employed or recommended by Home Depot/Expo Design Center	77	+	+	+	+	40		•	•
Contractor employed or recommended by Lowe's	76	+	+	++	+	39	•	•	•

+++ means 60% or more of readers surveyed reported excellence in this category; ++ means 50% to 59%; + means less than 50%.

Guide to the Ratings

Ratings are based on 13,461 responses to our Home Improvements Survey, conducted by the Consumer Reports National Research Center, about projects completed from 2003 through spring 2006. **Reader score** is based on overall satisfaction with installation. A score of 100 would mean that all readers were completely satisfied; 80 means very satisfied, on average; 60, fairly well satisfied. Differences of less than 9 points are not meaningful. **Excellence of service** is based on readers' ratings of four aspects of installation. **Problems** is based on how often readers had installation problems. **Percent with any problems** represents how often readers had one or more of these problems. Differences of less than 10 percentage points are not meaningful. The three specific problems listed were among the most frequently cited. Installers marked with a • had percentages higher than average. Note that our readers might not be representative of the U.S. population as a whole.