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INTRODUCTION AND SUMMARY

Rising house prices and incomes, an aging housing stock, and a pickup in household growth are all contributing to today's strong home improvement market. Demand is robust in coastal metros with especially high house values and household incomes. Demographic trends should continue to buoy the market over the next decade, with the rising tide of older homeowners accounting for more than three-quarters of projected growth. Although the huge millennial generation is set to shape future spending trends, younger households have been slow to break into homeownership and the remodeling market.

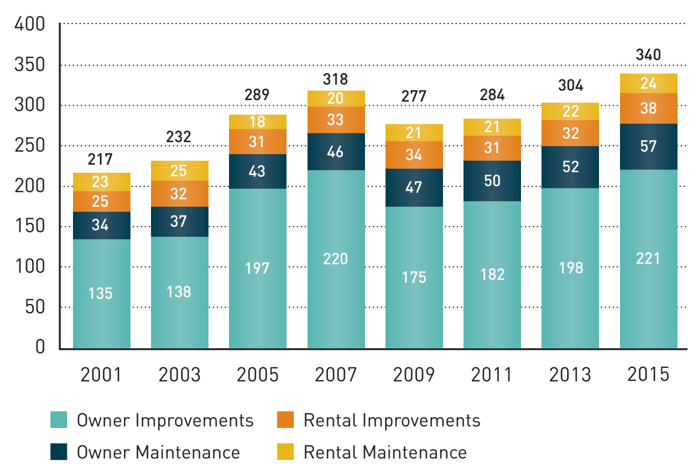
ACROSS-THE-BOARD SPENDING GAINS

Spending on improvements, maintenance, and repairs—including outlays by both homeowners and rental property owners—reached a record high in nominal terms of $340 billion in 2015, according to the latest estimates from the Joint Center for Housing Studies **(Figure 1).** This is an increase of 12 percent from the 2013 level and 7 percent from the recent market peak before adjusting for inflation. Market spending continued to climb in 2016, up an estimated 6 percent to $361 billion. With national house prices back to pre-recession levels and both household incomes and existing home sales on the rise, further growth is anticipated for 2017.

Figure 1

With All Segments Growing, the Home Remodeling Market Has Surpassed Its Previous Peak

Billions of Dollars



Sources: JCHS analysis of US Department of Housing and Urban Development (HUD), American Housing Surveys; US Department of Commerce, Retail Sales of Building Materials and Survey of Expenditures for Residential Improvement and Repairs (C-50); and JCHS Research Notes, October 2010 and April 2016.

The recent cycles in spending on the owner-occupied and rental stocks differ in timing and magnitude. Homeowner improvement spending fell sharply between 2007 and 2009 as house prices across the country went into a steep dive. The national recovery has been slow, reflecting the uneven rebound in house prices across metro areas and the overall decline in the homeownership rate. Rental improvement spending, in contrast, has surged since 2011 in response to soaring demand for rental housing.

Within the homeowner improvement market, the shares of spending in the two major project categories (discretionary and replacement) have also shifted since the downturn. Discretionary projects (including kitchen and bath remodels, room additions, and outside attachments) accounted for more than 40 percent of outlays in 2007 but a third of spending in 2015. Over this same period, the share of spending on replacement projects (including exterior and interior replacements and systems and equipment upgrades) increased from just over 40 percent to more than half.

As the home improvement recovery continues, investment in discretionary projects is expected to drive overall market growth, with high-spending households contributing a disproportionate share of outlays. Indeed, over the past 20 years, the top 5 percent of spenders on average accounted for at least a third—and up to half—of annual spending. Thus, while the share of owners that report spending on home improvements is fairly stable over time, average per owner outlays vary considerably **(Figure 2).**

The recent strength of discretionary projects has pushed up the home improvement and repair share of total residential construction spending at a time when the homebuilding recovery is still in progress. During the latter half of the 1990s and extending into the first half of the 2000s, the home improvement and repair share hovered around 40 percent of total residential investment, before rising to a peak of 70 percent during the housing downturn. The improvement share is now edging back toward half, where it is likely to stabilize.

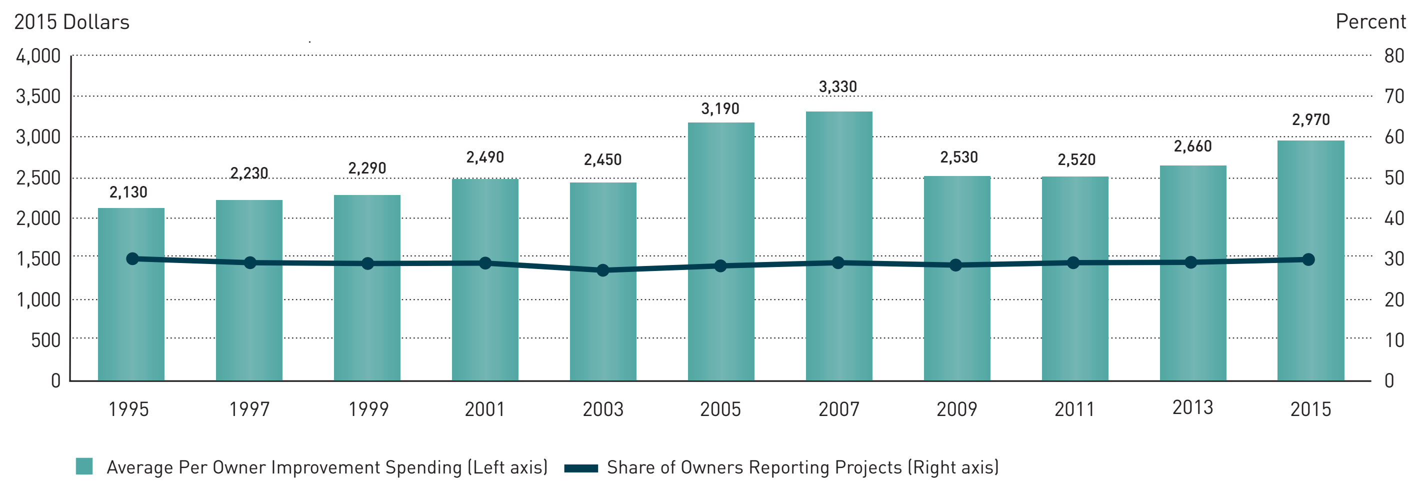
GEOGRAPHIC CONCENTRATION OF HIGH-SPENDING HOMEOWNERS

Even with widespread growth in the overall market, homeowner improvement expenditures are concentrated in metro areas with high house values and household incomes **(Figure 3).** The 25 major metros tracked by the 2015 American Housing Survey accounted for almost $100 billion in owner home improvement spending, or about 45 percent of the national total. Per owner spending of $3,400 in these metros was also about 15 percent above the 2015 national average.

The 25 major metros generally have elevated home values, driven in part by high homeowner incomes. The median home value of almost $270,000 in these areas is more than a third higher than the national median, while the median owner income of $83,000 is more than 15 percent higher. Owners in these markets not only have an incentive to make improvements to their homes to protect their larger investments, but they also benefit from higher home equity (generated by stronger house price appreciation) to fund those investments.

Figure 2

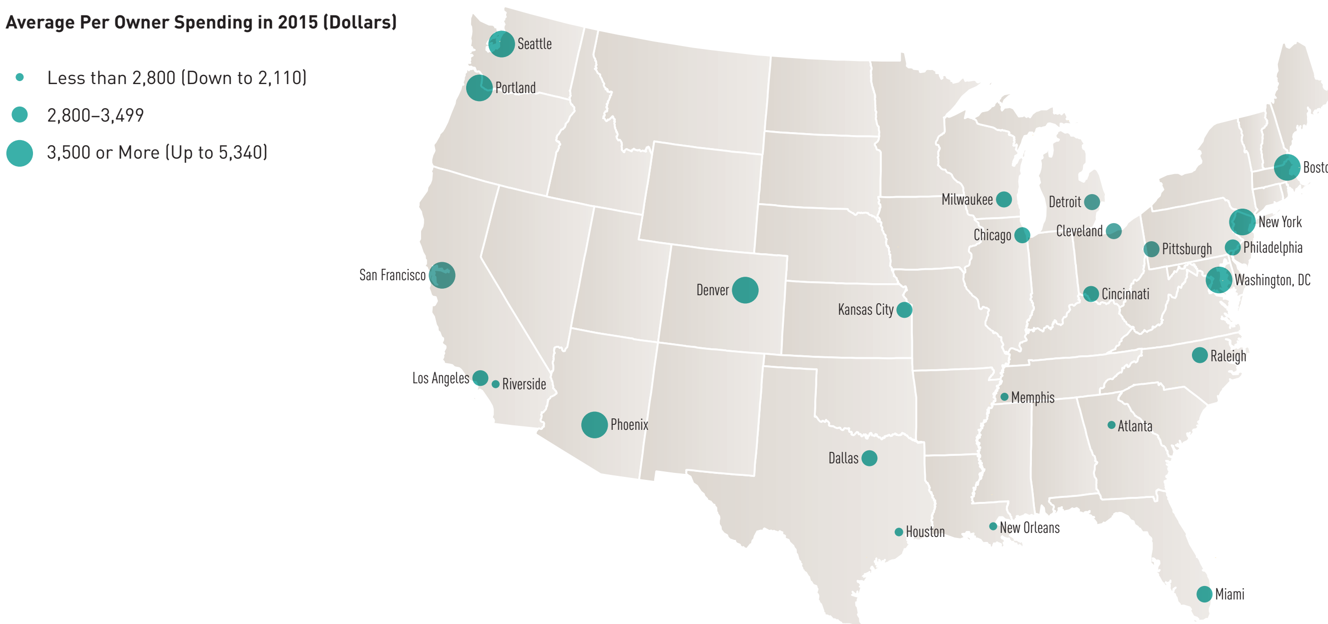
Owner Spending Levels—Not the Share Doing Projects—Drive Market Growth



Source: JCHS tabulations of HUD, American Housing Surveys.

Figure 3

Homeowners in Western and Northeastern Metros Generally Spend Most on Improvements



Note: Per owner spending for the 25 metros averaged $3,400 in 2015.
Source: Table A-8.

However, continued growth in home improvement spending in top markets may be challenged by the lack of affordable options for potential homebuyers. Nationally, the median house price is three times higher than the median household income. But in the top ten metros for per owner spending, house prices run five times incomes on average. And in San Francisco and Los Angeles, the price-to-income ratio is about nine.

These price trends may delay or prevent many younger households from buying homes, thus excluding them from the improvement market. Homeownership rates for households under age 35 are already depressed in a growing number of expensive markets. And younger households that are able to buy in these metros invest proportionately less in their homes than younger owners in more affordable markets.

HOMEBUYING CHALLENGES FOR MILLENNIALS

Younger households face a variety of challenges when it comes to homeownership. As of 2015, adults under age 35 made up 19 percent of households nationally but less than 10 percent of homeowners. Indeed, the homeownership rate for the under-35 age group fell from 43 percent in 2005 to a historic low of 31 percent in 2015—double the national percentage-point decline reported in the American Housing Survey.

The sharp downturn in the economy during the Great Recession and the ensuing weak recovery are in part to blame, with many younger households affected by slow job growth and weak income gains. Many of these households are also burdened with high levels of student debt. Moreover, tight credit markets and a general retreat from lending to the residential sector have also made it more difficult for even qualified households to buy homes.

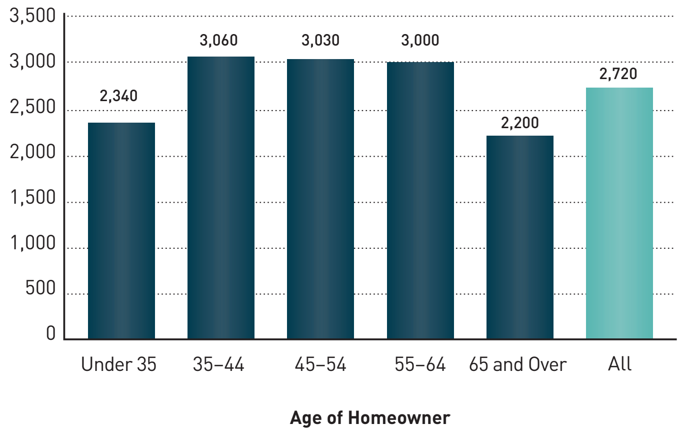
The challenging economy and changing social trends have led to delays in marriage and childbearing, the stages in life when households often buy homes. Concerns have arisen that, independent of economic and demographic factors, many younger households may not necessarily prefer to own. The claim is that many millennials want to live in urban locations closer to employment, commercial, and social centers; prefer the flexibility of renting; and are unwilling to take on the financial risks of ownership in the wake of the housing market collapse.

The evidence suggests, however, that homeownership decisions by younger households have much more to do with affordability than location and lifestyle preferences. Homeownership rates for the under-35 age group are in fact generally higher in metro areas where house prices are relatively low, such as

Figure 4

Outlays for Home Renovations Increase Sharply After Owners Reach Their Mid-30s

Average Annual Per Owner Improvement Spending, 2011–2015 (2015 dollars)



Source: JCHS tabulations of HUD, American Housing Surveys.

Birmingham, Detroit, Minneapolis, St. Louis, and Salt Lake City. Indeed, a Joint Center analysis found a more than 5 percentage point difference in the homeownership rates of younger households in metros where house prices were 20 percent below the national median and those where prices were 20 percent above the national median. This perhaps explains the higher homeownership rates for younger households in small towns and rural areas than in metro areas.

If the relatively low homeownership rate of the under-35 age group in fact reflects fundamental economic and demographic factors, their improvement spending may increase as they move into middle age and if job and wage growth pick up. In general, remodeling expenditures rise sharply among owners age 35 and over, thanks to higher incomes and growing families. Spending remains at this elevated level until homeowners approach their retirement years **(Figure 4).**

Given their late start toward homeownership, however, the ability of the millennial generation to catch up with the pace of home improvement spending among previous generations is uncertain. If households now under age 35 do not experience similar economic progress and demographic changes as the gen-Xers and baby boomers at the same stage of life, the typical jump in home improvement spending may well occur later and not continue long enough to make up for earlier deficits.

DEMOGRAPHIC DRIVERS IN THE DECADE AHEAD

Homeowner improvement spending should post healthy 2.0 percent average annual growth over the coming decade, with inflation-adjusted expenditures increasing from just over $220 billion in 2015 to almost $270 billion in 2025, according to Joint Center projections **(Figure 5).** Almost half of these gains are expected to result from an increase in average per owner spending as incomes and home values rise.

Growth in the number of homeowners will account for the other half of spending gains. Although members of the millennial generation have so far been slow to live on their own, the number of younger households should rise as the economy continues to improve. At the same time, older adults are increasingly able to remain in their homes as they age. As a result, the Joint Center projects a solid 13.6 million net increase in the number of households over the coming decade.

As younger households move into homeownership, they will supplement the already thriving improvement market. Gen-Xers are now in their prime remodeling years, and while some are still recovering from home equity losses after the housing crash, many in this generation will undertake discretionary projects deferred during the downturn. Meanwhile, the baby-boom generation has led home improvement spending for the past 20 years, and their influence shows no signs of waning. Their increased longevity and desire to live independently into old age will boost demand for remodeling projects that improve the accessibility of their homes.

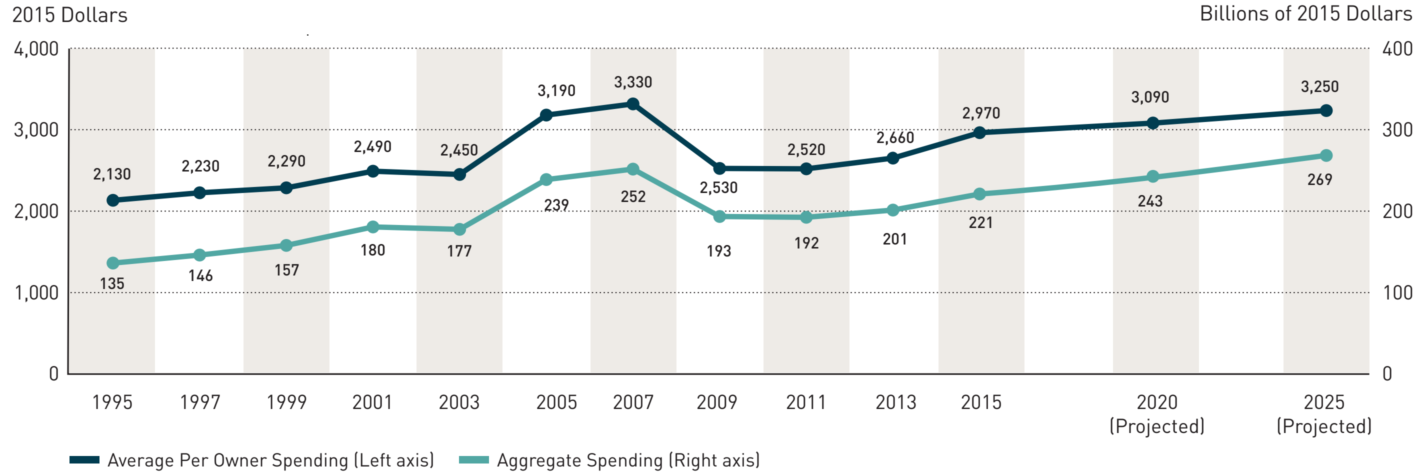
At the same time, however, a large number of older households will be unable to live on their own for health or financial reasons. As they move in with family, into nursing facilities or otherwise cease being a household, they will provide an important source of housing for tomorrow's owners. Joint Center projections suggest that such dissolutions of older households will free up more than 12 million housing units on net in 2015–2025. Many of these homes are well-suited for younger families in that they are typically older and more affordable. And given that older households generally live in their homes for some time and spend little on improvements in their later years, younger buyers of these homes will likely want to invest in significant upgrades.

THE REMODELING INDUSTRY OUTLOOK

While currently on solid footing, the home improvement industry faces a mix of challenges and opportunities. At the top of the challenge list is housing affordability. House prices nationally, at least on a nominal basis, have recovered nearly all of the ground

Figure 5

Homeowner Improvement Spending Is Poised for Solid Growth Over the Coming Decade



Sources: JCHS tabulations of HUD, American Housing Surveys; JCHS 2017 Remodeling Projections.

lost during the downturn, and long-term interest rates have started to tick up. Rising prices not only make homeownership more difficult for younger adults, but also leave those who are able to buy with fewer resources to make improvements. And while high rents may provide an incentive to buy homes, they also make it difficult to save for a downpayment.

At the same time, however, affordability considerations are likely to make older and outdated homes attractive to younger buyers, thus generating opportunities for improvement projects. And as a new generation of owners enters the remodeling market, several niches are likely to see significant growth. Energy-efficient products and systems, as well as alternative energy sources such as solar and geothermal, are likely to continue to gain popularity. Demand is also growing for sustainable home improvements, including projects that make use of renewable and recycled building products, improve water conservation, and address indoor health concerns. Home automation—encompassing everything from entertainment systems to home energy management, lighting, appliance control, and security—is emerging as an especially strong growth market, particularly among younger households.