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INDUSTRY STRUCTURE AND LABOR TRENDS

Remodeling contractors are experiencing a strong rebound, especially larger-scale firms that could take advantage of their size to gain market share during the downturn. While the remodeling industry is still highly fragmented, specialty trade or replacement contractors have been particularly successful in achieving scale economies and posting strong, steady growth over the business cycle. Meanwhile, industry employment is still well below the market peak and the construction workforce is aging. As housing and improvement demand revives, it will be critical for the industry to attract and develop a younger workforce.

Since the market bottom, the number of general residential remodeling firms with payrolls increased from less than 80,000 in 2011 to more than 83,000 in the second quarter of 2014, with the pace of growth accelerating each year. The industry has now recovered fully half of the payroll firms lost since the market peak. Job growth has been even faster, up 20 percent from the market low to an estimated 282,000 employees in 2014, restoring more than 60 percent of jobs lost during the downturn **(Figure 11).**

With employment levels outpacing growth in the number of firms, the average size of general remodelers has ticked up from a decade low of 2.9 payroll employees in 2010 to 3.3 in the second quarter of 2014. While still below the 2006 peak of 3.7 payroll employees, the firm size of general remodelers has thus returned to the decade average.

Unlike other industries within the broader construction sector, remodeling remains highly fragmented with large shares of self-employed contractors and small-scale, single-location payroll businesses. According to the most recently available economic census, the revenues of residential remodelers with payrolls averaged $700,000 in 2007—just one-third the size of a typical firm in the broader construction sector (including both residential and nonresidential), one-fifth the size of building material dealers, and one-tenth the size of wood product manufacturers. In fact, the average residential remodeling contractor with a payroll operated on even a smaller scale than the typical business serving the similarly fragmented accommodations and food services sector.

During the housing market downturn and Great Recession, the remodeling industry became even more fragmented. The share of general remodeling firms with fewer than five employees increased from less than 81 percent in 2007 to 84 percent in 2010, where it remained in 2012 (the most recent year for which data are available). Clearly contributing to this growing fragmentation, although difficult to quantify, is the increased presence of single-family home builders in the remodeling market since the housing crash. According to member censuses by the National Association of Home Builders (NAHB), the share of home builders that reported residential remodeling as a secondary activity jumped from 44 percent in 2008 to 50 percent in 2010 and remained at this elevated level as the new home construction market continued its own slow recovery.

PERFORMANCE OF LARGER-SCALE CONTRACTORS

The obstacles to achieving scale economies in the remodeling industry are many: low barriers to entry, volatile business cycles, and difficulty attracting capital, to name only a few. Firms that are able to overcome these hurdles, however, enjoy a long list of potential benefits, including stronger revenue growth, higher labor productivity, significantly lower failure rates, improved buying power, more efficient management, and increased brand recognition and trust. Indeed, the performance of larger-scale remodeling contractors in recent years provides clear evidence of the many advantages of scale and of the growing momentum toward full recovery from the worst downturn on record.

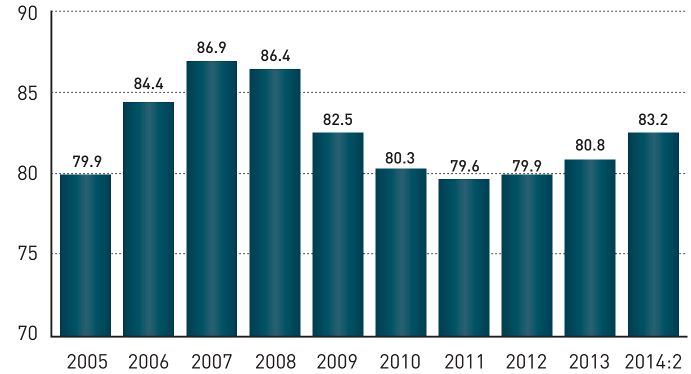
In 2013, firms on *Qualified Remodeler* magazine's Top 500 list reported median annual revenue growth of 10.8 percent, far outstripping the 3.6 percent increase in total market spending for professionally installed improvements that year. Indeed, recent revenue growth at these larger companies was even stronger than during the housing boom **(Figure 12).** Overall, revenues of larger-scale contractors grew 5.2 percent annually in 2010–13, compared with 4.6 percent annually in 2004–07. And now that homeowners are making some of the discretionary improvements that they deferred during the downturn, revenue growth at design/build and full-service firms is outpacing that at lower-ticket replacement contractors. The scale of the average job for companies in the Top 500 is also edging back up to the pre-recession level of $17,000, rising 15 percent between 2011 and 2013 to $13,000.

The very largest firms consistently outperform the rest of the remodelers on the Top 500 list by a considerable margin. In 2013, businesses ranked in the Top 100 reported average revenues of $43 million, while firms ranked below that group had average revenues of less than $4 million. The Top 100 remodelers also experienced significantly smaller losses during the downturn and much stronger gains during the recovery than other large contractors **(Figure 13)**.

Figure 11a

While the Number of General Remodeling Firms Is Growing Steadily...

Number of Firms with Payrolls (Thousands)

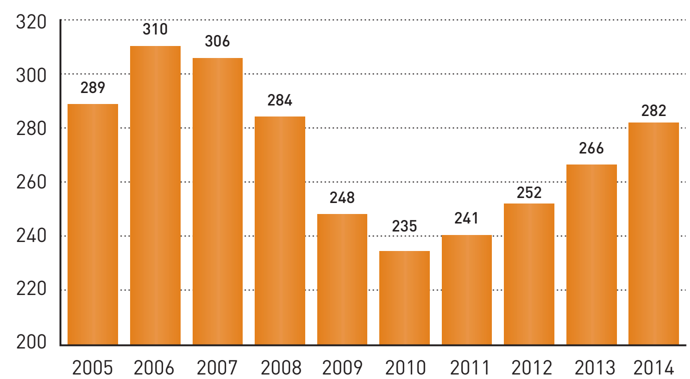


Note: Estimate for 2014:2 is preliminary.
Source: US Department of Labor, Bureau of Labor Statistics, Quarterly Census of Employment and Wages.

Figure 11b

...Employment Is Climbing Back Even More Quickly

Number of Employees at General Residential Remodeling Firms (Thousands)



Note: The 2014 estimate is annualized using reported data through November.
Source: US Department of Labor, Bureau of Labor Statistics, Current Employment Statistics.

DEVELOPING SCALE AND EFFICIENCIES THROUGH SPECIALIZATION

Since the remodeling industry encompasses many diverse business segments and market niches, there is no one-size-fits-all approach to achieving scale. Remodeling companies employ a wide variety of strategies that may involve partnerships with franchisors, investors, or nationally known manufacturing and retail brands.

Opportunities for scale and consolidation are especially likely to exist in the specialty replacements segment, which includes roofing, siding, windows, painting, cabinet refacing, bath liners and surrounds, and other kitchen and bath product replacements. Scheduling and installation of specialty replacement projects tend to be much less labor-intensive than for full-service remodeling projects, which means shorter job cycles and potentially higher margins. This specialization also allows replacement firms to develop greater efficiencies in their operations and obtain more favorable pricing on materials than full-service remodeling firms.

Specialty firms have pursued scale by focusing heavily on lead generation and sales and marketing, and by integrating with manufacturers of their core product lines. Specialization and vertical integration give companies substantial competitive advantages and provide significant value, thus strengthening their position for outside investment, mergers, or acquisitions.

Indeed, specialty replacement contractors represent a much greater share of the largest firms on the *Qualified Remodeler* Top 500 list. Over the past decade, these firms have made up 45–50 percent of the top 100 contractors on that list each year, compared with only 27–30 percent of companies ranking below 100. Given that specialty companies have already been more effective than full-service companies in achieving scale, it is likely that consolidation in this segment of the industry will increase moving forward.

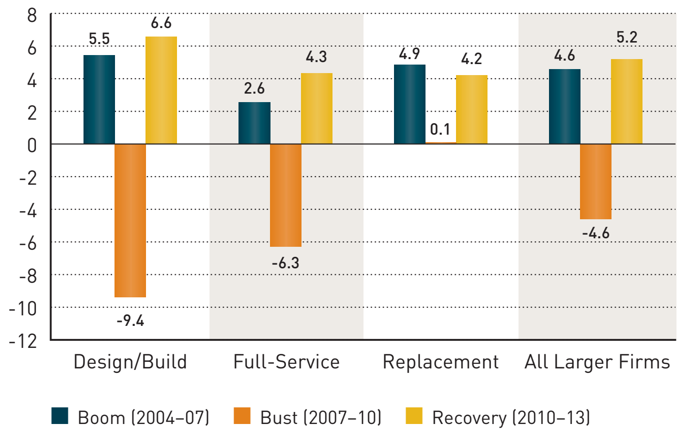
CHANGING CHARACTERISTICS OF THE WORKFORCE

Many construction workers have moved on to other industries or left the workforce entirely since the downturn. The labor force in the broader construction industry—including all employed or unemployed workers in construction and extraction occupations, whether self-employed or on a payroll—numbered 6.8 million in 2013 and represented 4.3 percent of the total US workforce. At the peak of the market in 2007, how-

Figure 12

Larger Contractors Have Seen a Sharp Rebound in Revenues

Median Compound Annual Change in Revenue for *Qualified Remodeler* Top 500 Firms (Percent)

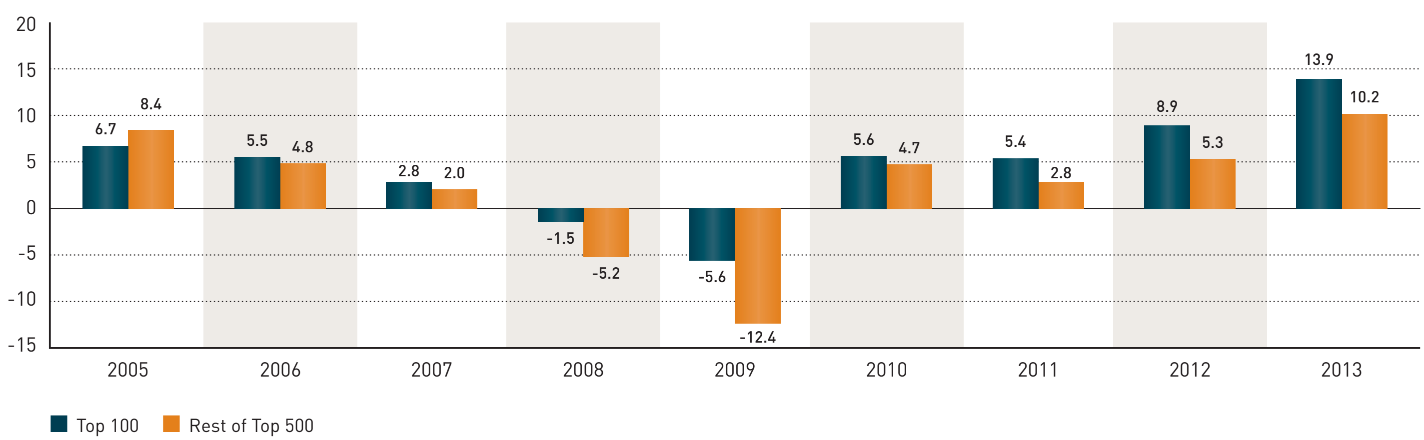


Notes: Companies qualifying for the *Qualified Remodeler* Top 500 list typically generate annual revenues of $1 million or more. Analysis includes firms reporting revenue in the beginning and ending years of each time period and ranking in the Top 400 in at least one of those years.
Source: JCHS tabulations of *Qualified Remodeler* Top 500 lists.

Figure 13

Revenue Growth at the Top 100 Remodeling Contractors Has Been Much More Stable than at Other Large Firms

Median Annual Change in Revenue for *Qualified Remodeler* Top 500 Firms (Percent)



Note: Companies qualifying for the *Qualified Remodeler* Top 500 list typically generate annual revenues of $1 million or more. Analysis includes firms reporting revenue in any two consecutive years and ranking in the Top 400 in at least one of those years.
Source: JCHS tabulations of *Qualified Remodeler* Top 500 lists.

ever, the construction labor force was 1.5 million stronger and accounted for a 5.5 percent share of the national workforce.

The demographic characteristics of those engaged in construction and extraction occupations are strikingly different from those of the national labor force **(Figure 14).** The largest disparity is in the share of women, who made up only 2.5 percent of the construction labor force in 2013, compared with nearly half of the total workforce. Less than 31 percent of construction workers had education beyond a high school diploma or GED, compared with nearly two-thirds of the national workforce. And fully 28 percent of construction workers were foreign-born, compared with less than 17 percent of the national labor force. While figures specifically for the residential remodeling labor force are not available, the profile of workers is likely to be quite similar to that of construction workers overall.

The large differences between the construction and national workforces are important as the industry looks to rebuild its ranks. The general concern is that the construction sector might have difficulties securing the labor force it needs if it cannot broaden its hiring to include more female, college-educated, and native-born workers, especially given the uncertainty surrounding the current immigration system. The fact that the construction sector has not traditionally attracted women and more educated workers has likely contributed to the aging of the labor force. From 2002 to 2013, the share of the construction workforce aged 55 and over increased from under 9 percent to almost 16 percent, and the share of the workforce under age 35 declined from 44 percent to less than 35 percent.

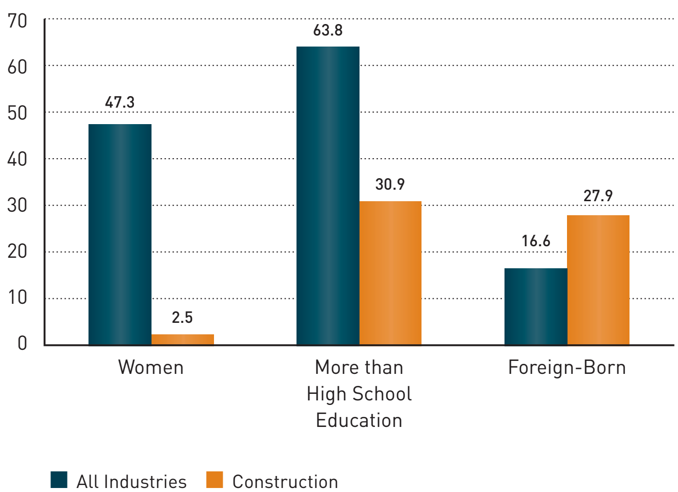
The inability to attract young workers is detrimental to the future vitality of the industry. This concern relates not only to workers that left construction for more stable sectors, but also to the industry's ability to find new skilled workers. Indeed, a 2013 survey by the Associated General Contractors of America indicated that fully 45 percent of member respondents considered the quantity and quality of local college, trade school, and apprenticeship programs to be poor or below average. Better preparation of younger workers is clearly necessary.

Immigrants remain a major source of labor for the construction industry, although their characteristics changed in meaningful ways during the industry boom and bust **(Figure 15).** While most foreign-born construction workers come from Mexico, their share of the immigrant labor force declined noticeably from 62 percent in 2002 to 57 percent in 2013. The drop in share of young immigrant workers was even more dramatic, falling from 55

Figure 14

The Construction Workforce Differs from the Overall Labor Force in Several Key Areas

Share of Labor Force in 2013 (Percent)

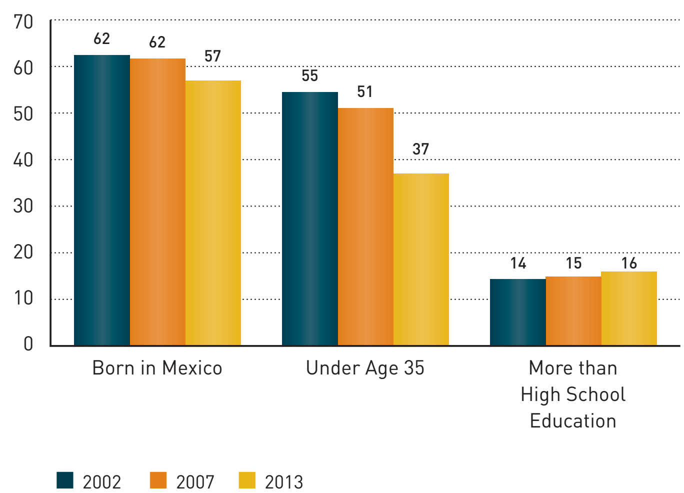


Notes: Data include all workers age 16 and over housed in non-group quarters and are employed or unemployed but available for and seeking work. The construction labor force includes workers with construction and extraction occupations in the construction industry.
Source: JCHS tabulations of US Census Bureau, American Community Survey.

Figure 15

The Characteristics of the Foreign-Born Construction Workforce Have Shifted Somewhat

Share of Foreign-Born Construction Labor Force (Percent)



Notes: Data include all foreign-born workers age 16 and over housed in non-group quarters and are employed or unemployed but available for and seeking work. The construction labor force includes workers with construction and extraction occupations in the construction industry.
Source: JCHS tabulations of the US Census Bureau, American Community Survey.

percent to only 37 percent over this period. Although the share of immigrant construction workers having more than a high school education inched up over the decade, it still stood at only 16 percent in 2013—less than half the share of native-born workers. Future immigration levels will certainly be an important factor in whether the construction industry is able to meet its demand for younger, less educated workers.

THE OUTLOOK

Although the remodeling industry will almost certainly remain more fragmented than the overall construction sector, opportunities for consolidation and economies of scale are especially likely in the specialty replacement segment. Companies that are focused on branding and customer satisfaction, developing and retaining skilled labor, and finding innovative uses of technology will also gain competitive advantage.

The massive decline in, and aging of, the construction industry labor force following the Great Recession have raised alarms about potential shortages of both skilled and unskilled workers as the market recovers. Ultimately, the construction and remodeling industries will need to attract new employees from key segments of the labor force whose shares have either declined or stagnated in recent years—in particular, young, female, and immigrant workers.