

5

Growth Markets for Remodeling



While the timing and magnitude of a remodeling turnaround are difficult to predict, it is clear that the home improvement industry can no longer rely as heavily on upper-end discretionary projects to drive growth in the future. Instead, it must capitalize on emerging opportunities as the market adjusts to new economic realities.

Of the sources of demand that are most likely to boost improvement spending, three stand out: the increasing need to upgrade the rental housing stock, ongoing growth in the immigrant homeowner market, and emerging interest in sustainable remodeling projects.

In the aftermath of the mortgage market meltdown, homeownership has lost some of its appeal. In addition, some households that would otherwise buy homes are no longer able to qualify for loans under today's more stringent underwriting standards. As households increasingly choose to rent rather than own their housing, the need to invest in the nation's aging rental stock will provide a prime opportunity for remodeling contractors.

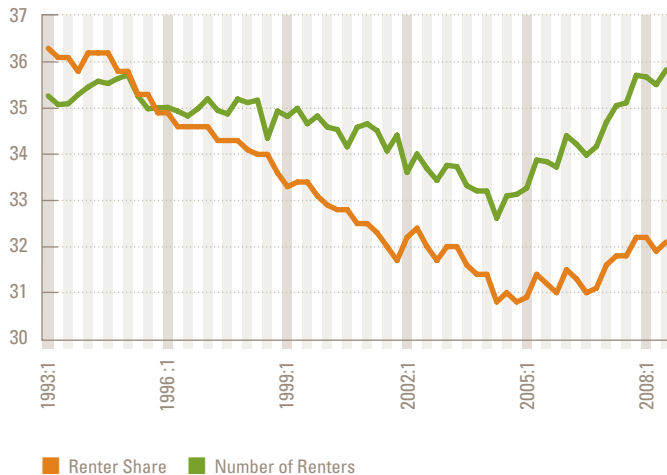
Meanwhile, immigrant households represent an increasingly important segment of the housing market. Between 1995 and 2007, the number of immigrant households rose from 9 million to more than 15 million. When immigrants arrive in the country, many initially rent. As they climb the economic ladder, however, they move into homeownership at rates comparable to those of the domestic-born population. As a result, foreign-born homeowners will account for a growing share of improvement spending in the years ahead.

With affordability a key priority, homebuyers are now looking for more efficient and cost-effective systems in their homes. More than 40 percent of the owner-occupied housing stock, along with almost half of the rental stock, was built when energy costs were much lower and environmental impacts were of less concern. Older homes thus represent a tremendous market for green remodeling. Sustainable housing retrofits also have growing appeal to a new generation of environmentally aware homebuyers.

Figure 22

With Homeownership Rates Declining, Demand for Rental Housing Is on the Rise

Number of renter households (Millions); renter share of all households (Percent)



Source: US Census Bureau, Housing Vacancy Survey.

Reinvesting in the Rental Stock

During the decade when homeownership rates were soaring, the number of renter households fell from almost 36 million in 1994 to less than 33 million in 2004. Shrinking demand discouraged rental owners from investing in their properties and developers from building additional units. As a result, the median age of the rental housing stock now stands at 36 years, compared with 32 years for the owner-occupied inventory.

With the recent collapse of the for-sale market, demand for rental housing is now on the increase—both because homeownership has become less attractive and because many owners are losing their homes to foreclosure. High gas prices have also encouraged households to trim their commuting costs by moving closer to employment centers or public transportation options, where rental units are in greater supply. As a result, the share of renter households has grown in recent years (**Figure 22**).

Stronger demand should generate greater investment in the aging rental stock. Nearly half of rental units were built before the 1970s, and only 15 percent have been built since 1990. Combined with the normal wear-and-tear of high turnover rates, the aging of the rental stock has contributed to its general deterioration. In 2007, almost 10 percent of rental housing—more than 3.6 million units—was structurally inadequate.

The poor condition of the rental inventory reflects years of neglect. Throughout the 1970s and 1980s, expenditures on the owner- and renter-occupied stock moved in tandem, although per unit spending averaged about 30 percent less for rentals primarily because of their smaller size. Beginning in the early 1990s, however, their paths began to diverge. Average per unit improvement and maintenance expenditures for rental units fell by almost 40 percent in inflation-adjusted terms between 1990 and 2007, while expenditures on owner-occupied units increased almost 30 percent.

Rental housing therefore represents a growing market for the home improvement industry. The types of projects in demand do, however, differ from those for owner-occupied units. Spending is more heavily focused on replacements and system upgrades since it is often difficult to add onto or structurally modify rental units. In addition, higher turnover rates in the rental stock mean more maintenance is required. For example, rental property owners spent 38 percent of their budgets on maintenance and repairs in 2007, while homeowners devoted only 20 percent to this expenditure category.

Despite the compelling need for significant reinvestment in the rental stock, current housing market conditions are likely to delay the process. Overbuilding in many metropolitan areas has produced a glut of vacant for-sale units, as well as of empty homes held off the market until conditions improve. Until this excess inventory is absorbed, many of these homes will be at least temporarily converted to rentals. This additional supply will reduce rents and dampen the demand for older units, discouraging rental property owners from making improvements in the near term.

The Growing Immigrant Market

Immigrants are key to the future growth of the US home improvement industry. In 2007, foreign-born households spent about \$23 billion on improvements to their homes (**Figure 23**). Their spending levels have grown almost 13 percent per year since 2000—well in excess of the 7 percent among the domestic-born population. Growth was particularly strong during the middle of the decade when overall spending was rising rapidly. As a result, immigrant owners now account for more than 10.0 percent of home improvement expenditures, up from 8.5 percent earlier in the decade.

A large part of this growth reflects steady increases in the number of immigrant homeowners. But even on a per household basis, spending by foreign-born owners has equaled or exceeded that of their native-born counterparts in recent years. One reason for this spending strength is their age distribution: immigrants represent more than 20 percent of the population between the ages of 30 and 44, the years when families are typically growing, when space is at a premium,

and when households may be inclined to modify the use of space in the home. This age group traditionally spends heavily on home improvements.

In addition, immigrant households tend to settle in gateway cities along the California coast, as well as in Texas, southern Florida, and the Northeast corridor. In these high-cost housing

markets, owners devote a relatively large share of their incomes to home improvements. In the 12 metropolitan markets where foreign-born homeowners spent at least \$500 million on home improvements in 2007, the immigrant share of expenditures was well above the national average of just over 10 percent (**Figure 24**). In five metro areas—Houston, Miami, San Diego, San Francisco, and Washington, DC—immigrants contributed more than a quarter of all remodeling expenditures.

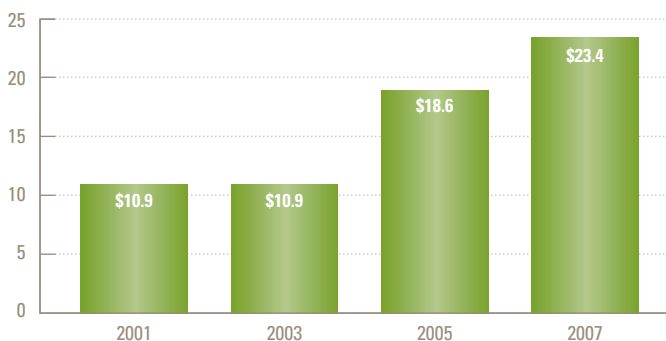
While still concentrated in gateway areas, immigrants have dispersed to an increasingly broad array of housing markets. In 1990, 33 percent of the foreign-born population lived in California alone and 68 percent lived in just five states: California, New York, Florida, Texas, and New Jersey. By 2007, California was home to only 26 percent of the foreign-born population, and the share in the top five states dropped to 61 percent.

Immigrant households will provide a growing source of remodeling demand as their numbers continue to rise. Between 2000 and 2005, the foreign-born population increased by just over 1.1 million a year, accounting for about 40 percent of total population growth during that period. Recent Census Bureau projections indicate that their share of growth will expand to about 44 percent by 2010 and almost 50 percent by 2025. As they form households and buy homes, immigrants are likely to account for similar shares of the growth in remodel-

Figure 23

Immigrant Homeowners Have Continued to Increase Their Spending on Improvements

Improvement spending by foreign-born homeowners (Billions of dollars)



Source: JCHS tabulations of the 2001–2007 AHS.

Figure 24

Immigrants Contribute Significantly More to Improvement Spending in Gateway Cities

Foreign-born homeowner share of spending, 2007

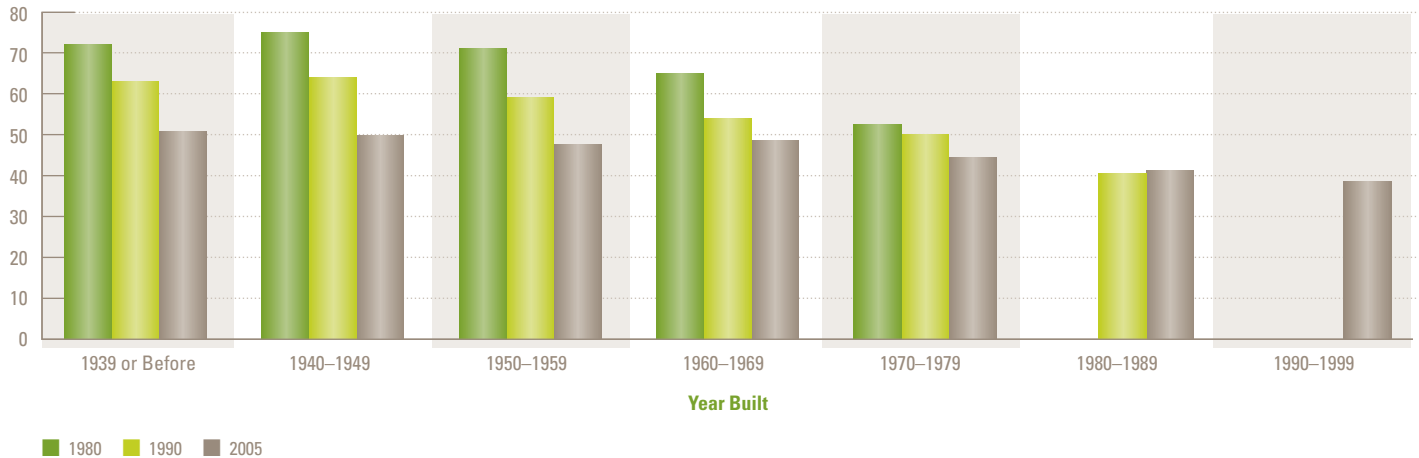


Note: Sample includes metro areas where immigrants spent at least \$500 million on improvements.
Source: JCHS tabulations of the 2007 AHS.

Figure 25

Remodeling Has Helped to Improve the Energy Efficiency of the Existing Housing Stock

Energy consumption per square foot (Thousands of BTUs)



Source: US Department of Energy, Energy Information Administration, Residential Energy Consumption Survey 1980-2005.

ing expenditures. Although the recession is now slowing the influx of foreign-born households, immigration should resume its strong pace once the economy recovers.

Emerging Interest in Sustainable Remodeling

Coupled with growing concerns about global warming, the recent surge in oil prices has helped to reinvigorate the sustainability movement. Energy efficiency in homes has become a central focus, given that the residential stock is a major contributor to national energy consumption.

With the sharp fluctuation in US energy costs since the 1970s, the energy efficiency of homes has improved, but only modestly. Advanced building techniques as well as more efficient equipment and appliances have helped to reduce energy usage in newer homes. According to a 2005 US Department of Energy survey, a home built in the 1990s uses about 40 BTUs of energy per square foot, down from almost 50 BTUs per square foot for homes built in the 1960s.

Efficiency gains within the existing housing stock have been more significant. In 1980, occupants of a typical 1960s home used 65 BTUs of energy per square foot. By 2005, their usage was 25 percent lower (**Figure 25**). Homes built in the 1950s or earlier show even greater efficiency improvements over time. Some of these savings result from removing older, less energy-efficient homes from the stock, and others from households

changing their behavior to conserve more energy. Still, the bulk of the efficiency gains likely arise from retrofitting older homes and their systems.

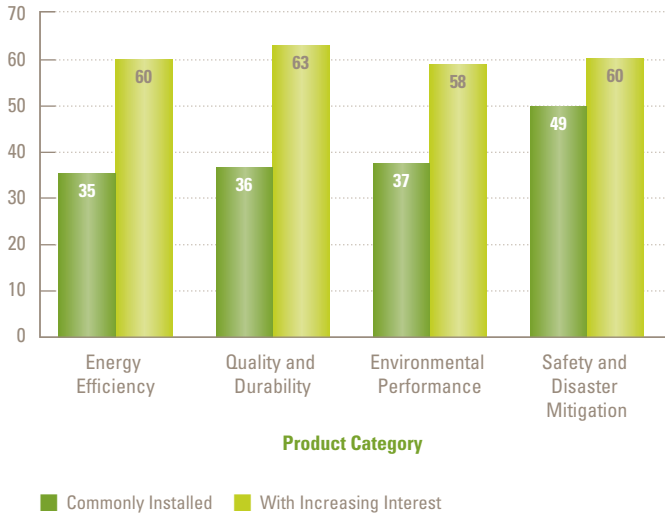
Homeowners can improve energy efficiency by replacing appliances and lighting systems, upgrading their HVAC systems, and enhancing the insulating properties of the home's exterior. According to US Department of Energy studies, space heating and air conditioning account for almost half of residential energy consumption, water heating for 20 percent, and appliances and lighting for the remaining 32 percent. In 2007, homeowners devoted over \$52 billion of their improvement expenditures to energy-related projects, up from less than \$33 billion in inflation-adjusted terms a decade earlier.

Sustainable design, however, goes well beyond energy efficiency. Motivated by broader environmental concerns, consumers have demonstrated a growing interest in products and projects that meet three additional green goals: quality and durability, environmental performance, and safety and disaster mitigation. In a recent survey conducted in conjunction with Specpan, the Joint Center asked a panel of full-service remodeling contractors about how frequently they installed green products that met at least one of these four criteria. The survey focused on 10 products listed by the Partnership for Advancing Technology in Housing (PATH) as having the "most promise for making our existing homes more durable, stronger and more resource efficient."

Figure 26

Interest in Green Remodeling Extends Beyond Energy Efficiency

Average responses by remodeling contractors (Percent)



Notes: Product categories defined by PATH. Commonly installed includes responses indicating that contractor installs product regularly or occasionally. See JCHS Working Paper W09-1 for more details.
Source: JCHS 2008 national green remodeling survey, administered by Specpan.

Respondents indicated that they were no more likely to install energy-efficient products on average than products promoting the other three goals. About 40 percent stated that they regularly or occasionally installed products in each of the four categories (Figure 26). Some products with energy-saving properties, such as high-performance windows, were used almost universally, while others such as tubular skylights had not yet penetrated most markets.

To gauge future trends, the survey also asked remodeling contractors to identify products for which consumers have expressed increased interest. Here again, there were no major differences between products promoting energy efficiency and those meeting other green objectives. Nevertheless, interest in specific products within each category varied widely. For example, among the products providing greater energy efficiency, more than 80 percent of contractors noted greater consumer interest in compact fluorescent lighting, but only half saw greater interest in wireless lighting and temperature controls.

These findings support a growing body of research indicating that interest in green remodeling is widespread and increas-

ing. Growing concern for sustainability offers the homeowner or rental property owner additional motivation for undertaking home improvement projects. With younger age groups expressing particular interest in green projects, this market holds promise for growth for many years to come.

To meet this emerging demand, residential building product manufacturers and distributors are offering a broader range of environmentally sensitive products. Remodeling contractors are also tapping into this market. Programs to certify home improvement contractors in green remodeling are among the most popular in the industry. Indeed, many contractors have chosen to focus on green remodeling, a specialization that allows them to focus their activities in a growing market niche and therefore operate more efficiently and profitably.

The Outlook

This decade has been a study in extremes for the home improvement industry. Early on, favorable economic conditions—easy access to credit, rapidly appreciating home values, rising home sales, and high cost recovery rates for home improvements—supported exceptionally strong growth in remodeling expenditures. Since late 2007, however, house prices have plunged across the country, homes sales have fallen, and credit has dramatically tightened, leaving the remodeling industry in one of its steepest declines in recent memory.

As the housing market stabilizes and the broader economy begins to recover, remodeling activity will return to a more normal pace of growth. As credit conditions thaw, owners will find it easier to finance their home improvement projects. As home prices edge back up, owners will again see the wealth-building benefits of investing in their homes. And as sales pick up, recent buyers will want to make improvements as they settle into their new homes.

The fundamentals of the US home improvement industry are compelling. Over the coming decade, the nation's housing stock will have to accommodate some 14–15 million additional households—about half of which may be foreign-born. The strong pace of household growth will ensure that the nation's housing stock will also grow, that existing units will be in high demand, and that older homes will need to be adapted to the needs and desires of new owners. These are the forces that have created the \$300 billion remodeling industry and that ensure its continued expansion over the coming decades.