



FACT SHEET

Improving America's Housing 2009

RELEASE DATE: FEBRUARY 4, 2009

PURPOSE

Improving America's Housing is prepared biennially by the Remodeling Futures Program at the Joint Center for Housing Studies of Harvard University. Since 1999, these in-depth reports have served as an essential resource for the remodeling industry. The latest edition, *The Remodeling Market in Transition*, provides an assessment of home improvement industry dynamics in the face of dramatic challenges to the national economy.

FINDINGS

Like the overall housing market, the U.S. home improvement industry is mired in a severe downturn. With home prices falling, owners are shifting from high-end discretionary improvements to those that maintain the structural integrity and efficient functioning of their homes, as well as generate cost savings. Similarly, contracting businesses serving the remodeling industry are likely to undergo fundamental changes, as even in the best of times, remodeling contractors experience very high failure rates. While leading indicators suggest the remodeling market has yet to reach bottom, the correction is still expected to be much less severe than in home building. New sources of future growth are already emerging, including the need to upgrade the nation's aging rental stock, the rapidly expanding market of foreign-born homeowners, and an increasing demand for green remodeling solutions.

Navigating Remodeling Cycles

The current remodeling cycle has been more extreme than previous cycles, largely due to the growing share of expenditures on upper-end discretionary projects such as major kitchen and bath remodels and room additions. This emphasis on high-end projects helped boost the remodeling market to new heights, but at an unsustainable rate. Project activity is shifting back toward exterior replacements and system upgrades, which tend to be most cost-effective in terms of generating energy savings.

- The share of remodeling expenditures for upper-end discretionary projects increased from 20 percent to 30 percent of total spending between 1995 and 2007.
- Upper-end discretionary spending is about twice as volatile as mid-range improvements and replacements with annual growth ranging from -5 percent to 23 percent between 1995 and 2007.
- Remodeling expenditures typically rise less than residential construction spending during an upturn and decline less during a downturn. Through the third quarter of 2008, new residential spending had declined more than 50 percent from its recent peak, while improvements spending had declined only 16 percent.

Emerging Industry Structure

The remodeling industry remains extremely fragmented with few signs of consolidation—a structure that exposes remodeling contractors to considerable risk. The recent trend toward specialization is likely to reverse itself during the current downturn as intensifying competition pushes contractors to pursue a broader range of projects. Due to the fragmented nature of the industry, contractor failure rates are relatively high even during a strong market, and smaller firms and start-ups are particularly vulnerable to failure. While smaller remodelers bear the brunt of the spending slowdown, larger firms are by no means immune.

- General remodeling firms with estimated revenues under \$100,000 in 2003 had a one-year failure rate of 22 percent in the midst of a remodeling boom—almost twice as high as all remodelers, while fully 20 percent of start-ups failed.
- Larger remodelers typically have more resources to ride out downturns, yet this spending slowdown has considerably weakened growth in recent years. By 2007, median annual revenue growth of remodelers had fallen to less than 3 percent from a peak of 12.5 percent in 2004, with 40 percent of large firms experiencing declining revenues that year.

- Consistent with higher average project costs, large design/build and kitchen and bath firms experienced significantly more year-to-year revenue volatility between 2000 and 2007, where sharp swings tend to create major challenges for contracting businesses, while exterior replacement firms reported the most stable annual revenues over the period.

Changing Geography of Improvement Spending

The areas of the country hardest hit by the housing market slowdown—where house prices and home sales have collapsed and where mortgage defaults and foreclosures are mounting—are likely to see the greatest declines in home improvement activity this cycle.

- Owners extracted an average of \$450 billion a year in home equity between 1999 and 2008 and reinvested more than 25 percent of extracted equity into home improvements. Since 2005 home equity has fallen 32 percent, drastically reducing this source of improvement spending, especially in places such as California and Nevada where house prices have plummeted over the past year.
- Recent movers spend about 23 percent more on improvements, but with housing sales down substantially from their peak, there will be fewer new occupants upgrading and modifying their homes. Areas such as Florida, which have seen the largest decline in sales, will face even sharper declines in spending.
- Markets with rapidly appreciating home values earlier in the decade saw the highest cost recovery from home improvement projects, but are now experiencing the sharpest declines. Most of the top 10 metropolitan areas in terms of house price declines report much lower cost recovery now, with the average share down 28 percentage points between 2005 and 2008.

Growth Markets for Remodeling

Of the sources of demand that are most likely to boost improvement spending as the remodeling industry emerges from the downturn, three stand out: the increasing need to upgrade the rental housing stock, continued growth in improvements spending by foreign-born homeowners, and mounting interest in sustainable remodeling projects.

- Average expenditures for rental homes fell by almost 40 percent between 1990 and 2007, while expenditures on owner-occupied units increased nearly 30 percent. Almost 10 percent of rental housing—more than 3.6 million units—was considered structurally inadequate in 2007 and in need of remodeling.
- In 2007, foreign-born homeowners spent over \$23 billion on home improvements, and their spending levels have grown almost 13 percent per year since 2000—well in excess of the 7 percent growth by native-born households. Immigrant households will provide a growing source of remodeling demand as their numbers continue to rise.
- Occupants of a typical 1960s home used 25 percent less energy per square foot in 2005 than in 1980 largely due to improvements to the housing stock. Higher energy prices and greater environmental awareness will increase the demand for green remodeling projects.

SPONSORS

The Remodeling Futures Steering Committee and the Policy Advisory Board of the Joint Center for Housing Studies provide principal funding for the report. Additional support is provided by Masco Corporation.

CONTACT INFORMATION

For more information about *Improving America's Housing* reports, please contact Angela Flynn at (617) 495-7908 or angela_flynn@harvard.edu.