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THE ROLLERCOASTER DECADE

The past decade was the best of times and the worst of times for the remodeling industry. The 2000s began with a surge in house prices that generated massive gains in home equity. Thanks to easy lending standards, many owners were able to tap this equity to finance upper-end discretionary improvements.

When the housing bubble burst and the national economy entered a deep recession, however, incentives for discretionary spending vanished. Even spending on do-it-yourself (DIY) projects lost ground during the downturn.

When the national homebuying boom began to pick up momentum in the early part of the 2000s, total spending on improvements to rental as well as owner-occupied properties was growing at a respectable 5 percent average annual rate. As the housing bubble expanded between 2003 and 2007, expenditure growth escalated to almost 12 percent per year on average. But with the housing market crash and the onset of the Great Recession, home improvement spending fell about 16 percent from its mid-2007 peak through 2009.

Improvement spending by homeowners alone plunged more than 23 percent over this period, according to data from the US Census Bureau. This drop is as severe as any the industry has seen in the past several decades **(Figure 6).** In comparison with the nearly 75 percent plummet in residential construction spending, however, the remodeling downturn has been modest over this cycle.

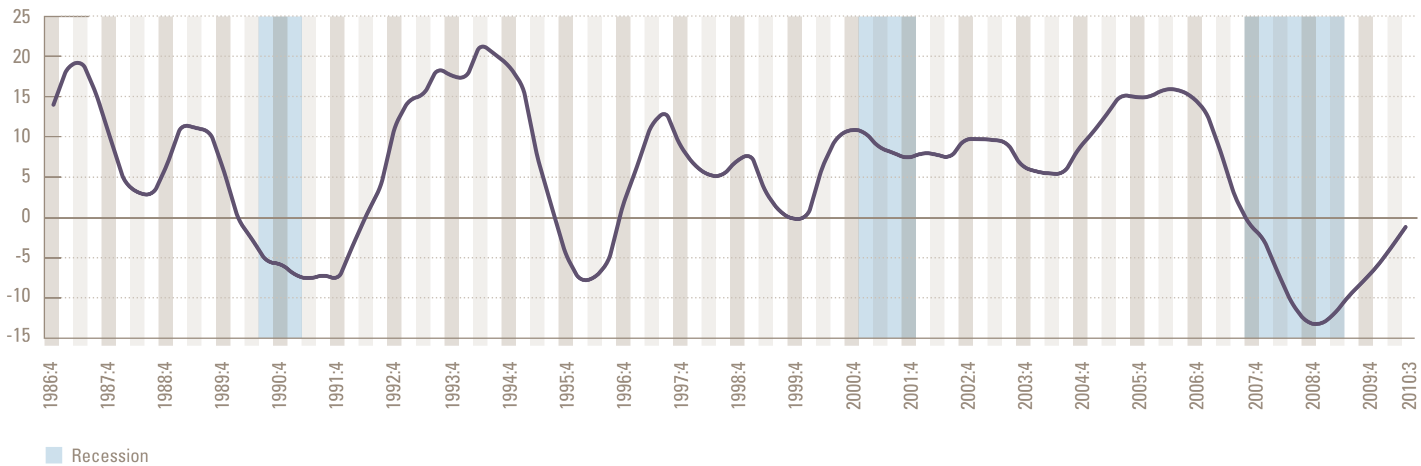
DRIVERS OF REMODELING ACTIVITY

Conditions in the first seven years of the decade were strongly favorable for the home improvement industry. House prices were climbing at an unprecedented pace as low mortgage interest rates and relaxed lending standards enticed more households into homeownership. Rising house prices not only encouraged owners to make improvements to their homes, but also provided growing amounts of equity to finance those projects. And with lenders offering attractive rates for home

Figure 6

The Recent Remodeling Downturn Is the Most Severe in at Least 25 Years

Annual change in homeowner improvement expenditures (Four-quarter moving totals, percent)



Notes: Rates of change for 1985–2007 were calculated using the C-50 series and for 2008–10 using the C-30 series. For methodology and greater explanation of historical remodeling cycles, see Abbe Will, *Understanding Remodeling Cycles*, JCHS Working Paper W08-6, August 2008.

Source: JCHS tabulations of US Census Bureau, C-50 and C-30 series, and National Bureau of Economic Research, US Business Cycle Expansions and Contractions.

equity loans and easy credit, owners had ready access to their windfall housing wealth.

The decision to make home improvements was easy to justify during this period. Indeed, rapid house price appreciation immediately offset a large share of the project cost, exposing owners to little risk as long as prices kept climbing. According to Cost versus Value studies conducted by *Remodeling* magazine and the National Association of Realtors®, owners could recover more than 80 percent of a home improvement's cost on average between 2003 and 2005.

By 2007, though, most of the incentives to undertake home improvement projects had become disincentives **(Figure 7).** House prices were falling in most markets across the country, eroding much of the home equity built up earlier in the decade. In addition, the homeownership rate had peaked at more than 69 percent in 2004 and was trending downward. The drop in the homeownership rate is important for the remodeling industry because owner-occupants typically spend nearly twice as much on improvements per year on average as owners of renter-occupied units.

As the recession took hold, the number of distressed properties began to climb, further dampening improvement spending. By the first half of 2010, the share of mortgaged homes in the foreclosure process was approaching 5 percent, and almost a quarter of all home mortgages were underwater. Homeowners with loans in the foreclosure process typically have neither the resources nor the incentive to undertake improvements other than projects that address immediate threats to health or security. Similarly, banks and other owners of foreclosed properties are unlikely to make improvements until they are ready to put the houses on the market. Even then, they are apt to do only the minimum necessary to prepare the homes for sale. Only when new buyers take possession does spending on distressed properties increase as owners attempt to make up for deferred maintenance and to repair any damage from vandalism that may have occurred during the foreclosure process.

CONCENTRATION OF SPENDING

The national level of homeowner improvement spending depends in part on the number of owner-occupied housing units and the amount that each owner spends on projects. In general, project spending has turned out to be the primary determinant of overall remodeling market growth or decline.

Despite swings in improvement spending over the past decade, the number of homeowners grew at a very steady rate. Between 2001 and the peak of the homebuying boom in 2007, the number of homeowners increased by more than 5.5 million, or almost 1.3 percent per year. This is not unusual as the number of homeowners has increased by more than 1 percent annually for the past several decades.

Figure 7

Drivers of Remodeling Activity Deteriorated Sharply After 2007

Remodeling Drivers	2000	2007	2010	Percent/Percentage Point Change 2000–7	Percent/Percentage Point Change 2007–10
Average House Price (Index)	104.5	179.7	135.2	72.0	-24.8
National Homeownership Rate (%)	67.4	68.2	67.0	.08	-1.2
Homeowner Equity (Trillions of $)	7.0	11.4	6.8	62.9	-40.4
Average Share of Cost Recovered from Remodeling Projects (%)	n/a	70.1	60.0	n/a	-10.1

Note: 2010 data for house price index, homeownership rate and homeowner equity are through the third quarter.
Sources: S&P/Case-Shiller® National US Home Price Index; US Census Bureau, Housing Vacancy Survey; Federal Reserve Board, Flow of Funds; and *Remodeling* magazine, Cost vs. Value Report.

Figure 8

Higher Spending Per Household Drove the Market Upturn

	2001	2007	2009	Percent/Percentage Point Change 2001–7	Percent/Percentage Point Change 2007–9
Number of Homeowners (Millions)	70.0	75.5	74.9	7.9	-0.8
Share of Owners Reporting Improvement Projects (%)	28.7	28.8	28.1	0.1	-0.7
Average Spending of Owners Reporting Improvement Projects (2009 $)	7,760	10,830	8,790	39.6	-18.8
Discretionary Spending as Share of Total (%)	34.0	36.8	35.4	2.8	-1.4

Note: Discretionary spending includes kitchen and bath remodeling and other room additions.
Source: JCHS tabulations of the 2001–9 AHS and American Community Survey (ACS).

The share of households that decide to undertake home improvement projects in any given year also varies surprisingly little. Despite changing market conditions over the last 15 years, the share of homeowners reporting improvement projects only ranged from about 27 percent in 2002–3 to about 30 percent in 1994–5. Moreover, changes in share are somewhat countercyclical. Between 2002 and 2005 when spending growth was strongest, about 27 percent of owners were reporting improvements. Conversely, when spending fell sharply in 2008–9, the share of owners reporting project spending actually increased slightly to just over 28 percent.

Spending per household is therefore key. During the housing boom years, the mix of homeowner improvement expenditures tilted more toward discretionary projects. And within the discretionary category, homeowners devoted a larger share of spending to major projects such as upper-end kitchen or bath remodels and major room additions and alterations. During the downturn, the discretionary share of spending fell, along with the share of households undertaking major projects.

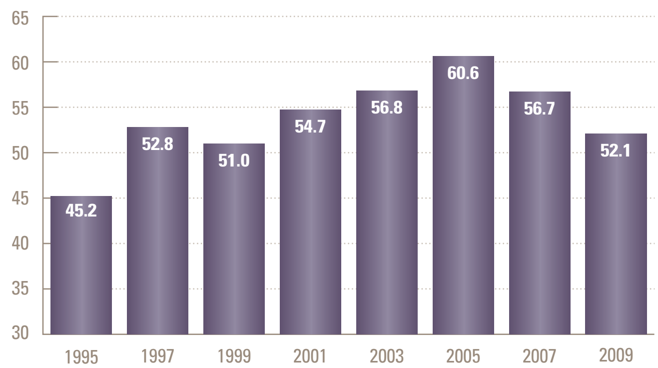
Thus while overall homeowner improvement spending increased 78 percent between 2000 and 2007, spending on upper-end discretionary projects was up 110 percent. The discretionary project share climbed from 34 percent in 2001 to nearly 37 percent in 2007 **(Figure 8).** When overall spending fell almost 19 percent in 2007–9, spending on upper-end discretionary projects dropped almost 23 percent. This brought the discretionary share of activity closer to levels in the late 1990s and early 2000s when the market was more balanced.

Given that participation in the home improvement market remains relatively steady during upturns but the mix of projects shifts toward upper-end discretionary projects, the concentration of spending changes as the remodeling industry moves through cycles. Homeowner spending on high-end projects thus accounts for a greater share of total improvement expenditures when the market is strong. Accordingly, the top 5 percent of owners contributed about 60 percent of expenditures during the boom years of 2002–7 but just over 52 percent during the bust in 2008–9 **(Figure 9).**

Figure 9

Spending Becomes More Concentrated During Periods of Strong Growth

Share of total spending by top 5% of owners (Percent)



Source: JCHS tabulations of the 1995–2009 AHS.

COPING WITH THE HOUSING DOWNTURN

Households suffering most from the weak economy and broader housing market downturn were especially likely to scale back on home improvement spending. In particular, owners that saw their house values plummet had little or no equity left to borrow against to pay for home improvements. Others that lost their jobs or experienced cutbacks in income during the national economic recession did not have the resources to undertake anything but the most essential projects. Still others that did have the resources to undertake home improvements often deferred doing so given the uncertain direction of house prices.

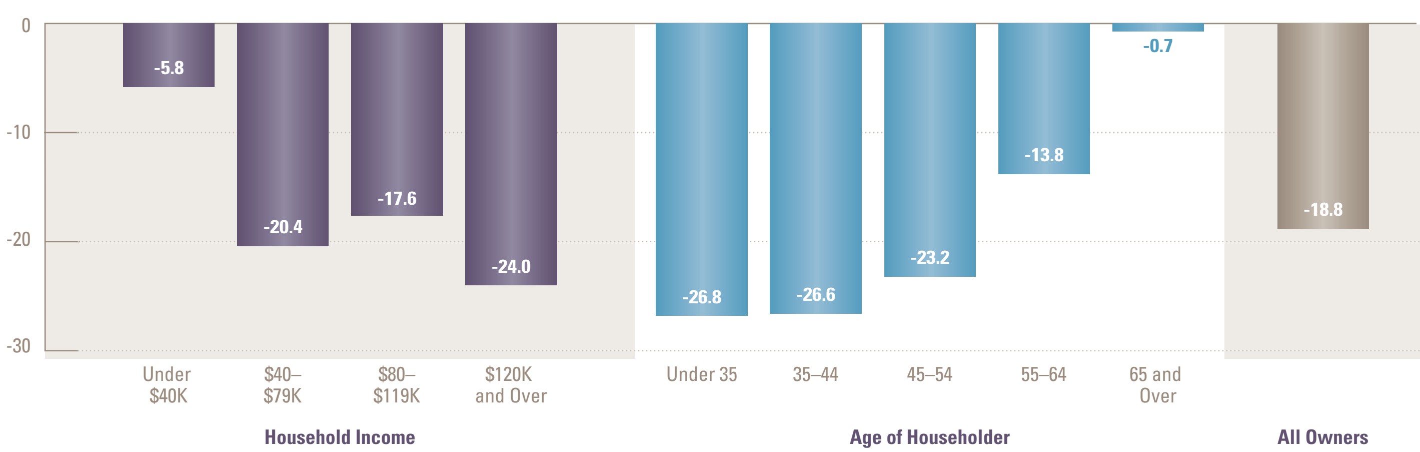
Recent homebuyers were hit especially hard by the housing market collapse. Households that bought near the top of the market had no opportunity to benefit from the surge in house price appreciation earlier in the decade and now have little or no equity in their homes. Owners living in suburbs of major metropolitan areas—particularly recently developed outer suburbs and exurbs where new construction activity was heaviest—also cut back more on home improvement spending than those living in center cities or in nonmetropolitan areas.

Similarly, higher-income owners reduced their expenditures between 2007 and 2009 significantly more than lower-income owners **(Figure 10).** Like all owners, upper-income households on average saw a substantial drop in their home values over this period. This group historically accounts for more high-end

Figure 10

Lower-Income and Older Owners Have Cut Back Least on Spending Since 2007

Change in improvement spending, 2007–9

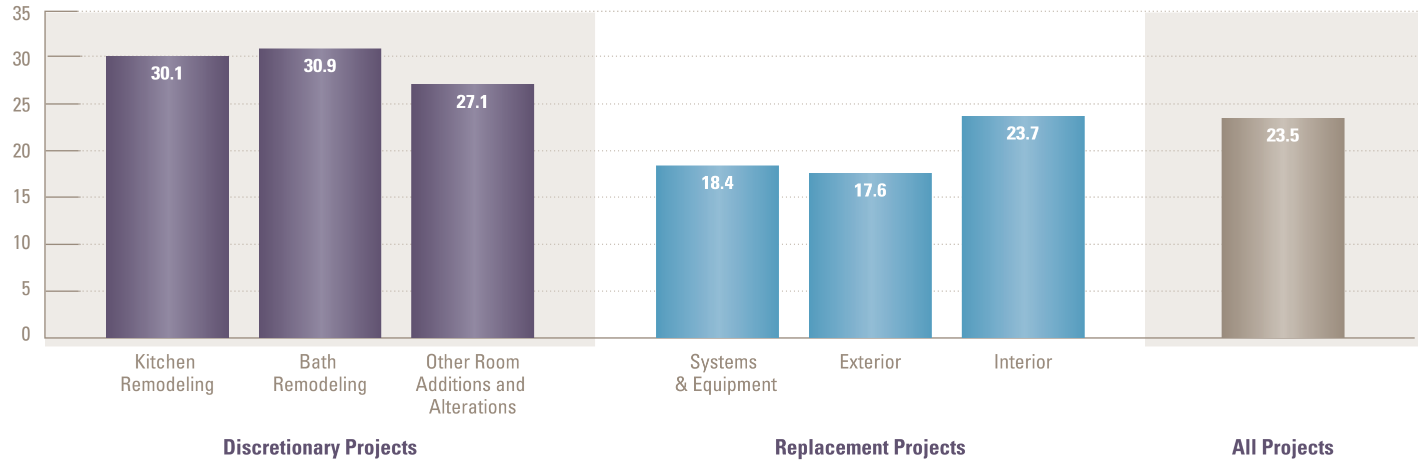


Note: Household income and spending are in 2009 dollars.
Source: JCHS tabulations of 2007–9 AHS.

Figure 11

The DIY Share of Spending Is Higher for Discretionary than for Replacement Projects

DIY share, 1995–2009 annual averages (Percent)



Source: JCHS tabulations of the 1995–2009 AHS.

discretionary projects—the segment where spending has declined the most during the downturn.

Home improvement spending by older owners has held up better. Older households have usually lived in their homes long enough to have a larger equity cushion if home prices fall. These owners also tend to spend more of their improvement dollars on replacement projects and system upgrades, that is, the spending categories that have fallen the least since 2007.

THE DO-IT-YOURSELF PUZZLE

The one home improvement spending category that might be expected to do better during an economic downturn is DIY projects. Homeowners can realize significant savings from performing the upgrades themselves rather than hiring a contractor to do the work. Oddly enough, however, the share of spending on DIY projects in 2008–9 was lower than at any time over the past 15 years.

The condition of the economy, it turns out, is only one of the factors influencing the DIY share. Household income also plays a primary role. While households across the spectrum undertake DIY projects, higher-income owners are somewhat less likely to do so than other groups. As a result, the income mix of households that make home improvements affects the DIY share. The age composition of households also helps determine the DIY share, with younger households—particularly younger families—much more likely to take on such projects than older households.

But among the most significant determinants of DIY activity is the mix of projects. Do-it-yourselfers are much more apt to undertake certain types of home improvements, including minor bath remodels, deck and porch additions, and insulation projects **(Figure 11).** In contrast, homeowners typically leave exterior replacement projects such as roofing or siding, as well as HVAC and other system upgrades, to professional contractors.

The availability of federal tax credits for energy retrofits, along with the usual decline in upper-end discretionary projects during economic downturns, altered the mix of home improvement projects in 2007–9. Thanks to these tax incentives, spending on professionally installed energy-related projects fell less than half as much as overall home improvement expenditures, further reducing the DIY share of home improvement spending.

As the mix of home improvement projects becomes more balanced in the years ahead, however, the DIY share should return to its longer-term average. Moreover, given that younger households are traditionally more active do-it-yourselfers, the entrance of the large Generation Y and subsequent cohorts into the housing market over the coming decade should in fact lift the DIY share of home improvement spending.