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A NEW DECADE OF GROWTH



The new remodeling decade is unlikely to produce the unusual highs and lows witnessed in the 2000s. As the economy moves toward a sustainable recovery, house prices should stabilize and slowly trend up. The inventory of distressed properties will gradually be absorbed and cost-recapture rates for home improvement projects should return to their longer-term average.

If these trends materialize, the growth and composition of home improvement spending over the coming decade should be similar to those in the late 1990s. During that period, homeowner expenditures increased 5–6 percent per year in nominal terms, the discretionary share of project spending averaged about 31 percent, and the top 5 percent of homeowners accounted for about half of total market spending.

The motivations for undertaking home improvements, however, will differ in some important respects in the coming years. The housing market crash has in fact opened up new market opportunities for remodelers. In particular, the growing numbers of foreclosed properties will need rehabilitation after years of underinvestment. In addition, households are moving less often and therefore are more likely to focus on improvements that accommodate their longer-term housing needs. Indeed, energy-efficiency retrofits—projects that make more financial sense if owners expect to remain in their homes for several years—were one of the home improvement categories that increased most in share over the 2007–9 period.

THE UPSIDE OF THE DOWNTURN

One of the major contributors to the remodeling industry slump is the rising number of distressed properties. Owners that are delinquent on their mortgage payments or going through the foreclosure process are unlikely to make improvements to their homes. Even if they have the resources to do so, these owners have little incentive to upgrade since they will not recoup any benefit from the investment.

According to the Mortgage Bankers Association's national delinquency survey, 4.4 percent of all home mortgages

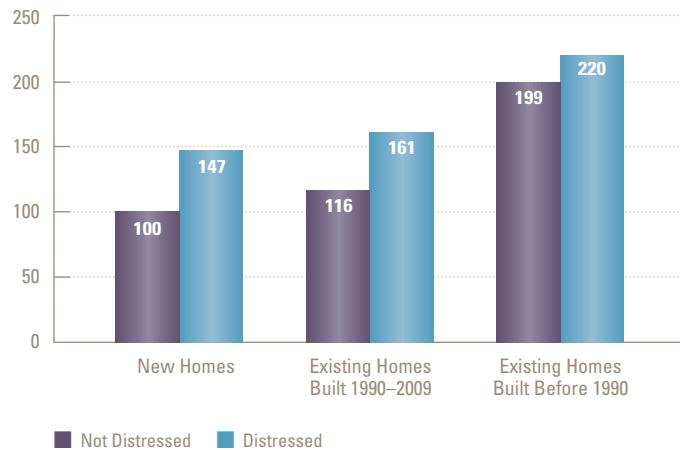
were in the foreclosure process in the third quarter of 2010. Meanwhile, RealtyTrac reports that properties that were either foreclosed or in the process of foreclosure made up about 25 percent of residential sales in that quarter. These homes sold for about a third less on average than those that were not distressed. Such large discounts in the selling price may reflect the fact that the homes are less desirable properties or in less desirable locations, or that the owner (often a bank) wants to sell as quickly as possible. But foreclosed homes are also likely to be in poor condition because of a lack of investment during the foreclosure process—a period that currently lasts almost 500 days on average. New owners may thus need to make up for this deferred maintenance.

Pent-up demand for improvements to distressed properties may be significant. A survey of 1,200 recent homebuyers conducted by the Home Improvement Research Institute in spring 2010 indicates that new owners of existing distressed properties spent almost 15 percent more on average than new owners of nondistressed properties (**Figure 22**). The difference in spending on new distressed and nondistressed homes is even greater. As these properties work their way through the foreclosure pipeline, home improvement expenditures will increase.

Figure 22

Buyers of Distressed Properties Are Spending More on Remodeling

Index of average remodeling expenditures in the first year after purchase, 2010



Notes: New distressed properties were either bought from a financial institution or from a builder or developer who “needed to sell the home as soon as possible.” Existing distressed properties were bought from a financial institution, purchased as a short sale, or had a loan in delinquency or in the foreclosure process.

Source: JCHS tabulations of the 2010 HIRI Recent Home Buyers Survey.

THE CHALLENGE OF LOWER MOBILITY

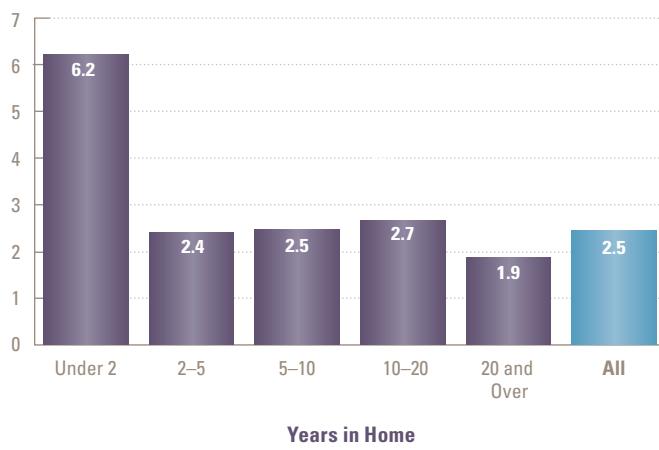
Lower household mobility is another product of the housing downturn. Many owners who would normally have moved in recent years have stayed in their homes either because they were holding out for higher selling prices or because they were underwater on their mortgages and unable to cover the difference between the outstanding loan balance and the sales price. At the same time, many potential buyers have had difficulty getting mortgages under today’s stricter underwriting standards, or have delayed purchases out of concern that home prices might decline further. The net result is that the national mover rate fell to just 11.9 percent in 2008—the lowest rate since the Census Bureau began tracking mobility in 1948. Moreover, only 35.2 million people changed residences in 2008, the lowest number since 1962.

While the Great Recession intensified matters, the national mobility rate has in fact been dropping for several decades. In 1985, close to one in five households moved each year. Two trends contributed to the ongoing decline—the aging of the population (because older households tend to change residence less often than younger households), and the rising homeownership rate through the mid-2000s (because owners are less mobile than renters).

Figure 23

Home Improvement Spending Declines Sharply After the Second Year of Ownership

Average annual spending per homeowner, 1997–2009
(Thousands of 2009 dollars)



Source: JCHS tabulations of the 1995–2009 AHS.

Mobility is unlikely to increase significantly as the recovery proceeds. Mortgage rates have been unusually favorable in recent years because of weak loan demand as well as Federal Reserve efforts to stimulate the economy. As a result, the overwhelming majority of households have either financed their home purchases or refinanced existing mortgages at what many think will be the lowest rates of their lifetime. As mortgage rates trend up in the years ahead, owners may be reluctant to move because it would require repaying their current loans and losing these attractive interest rates. This mortgage "lock-in effect" is likely to keep mobility rates low.

In general, lower household mobility would be expected to depress homeowner improvement spending. In fact, home sales are typically thought to be the best near-term indicator of a change in home improvement spending. Recent homebuyers spend more than twice as much on remodeling projects on average as owners that have not moved within the past two years (**Figure 23**). While dropping sharply after the initial burst of activity following a home purchase, remodeling expenditures slowly creep up over the first 20 years of ownership, then fall thereafter.

Under current circumstances, however, lower mobility may offset some of its traditionally negative effect on home

improvement spending. Rather than trade up, owners that remain in their homes to keep their low mortgage rates may want to upgrade their existing units. As owners make a longer-term commitment to staying in their current homes, they may be more likely to undertake certain improvement projects. For example, a roof replacement may make more sense than a temporary roofing repair. Upgrading an HVAC system or replacing older, less energy-efficient windows may also be a more desirable choice for owners planning to stay put.

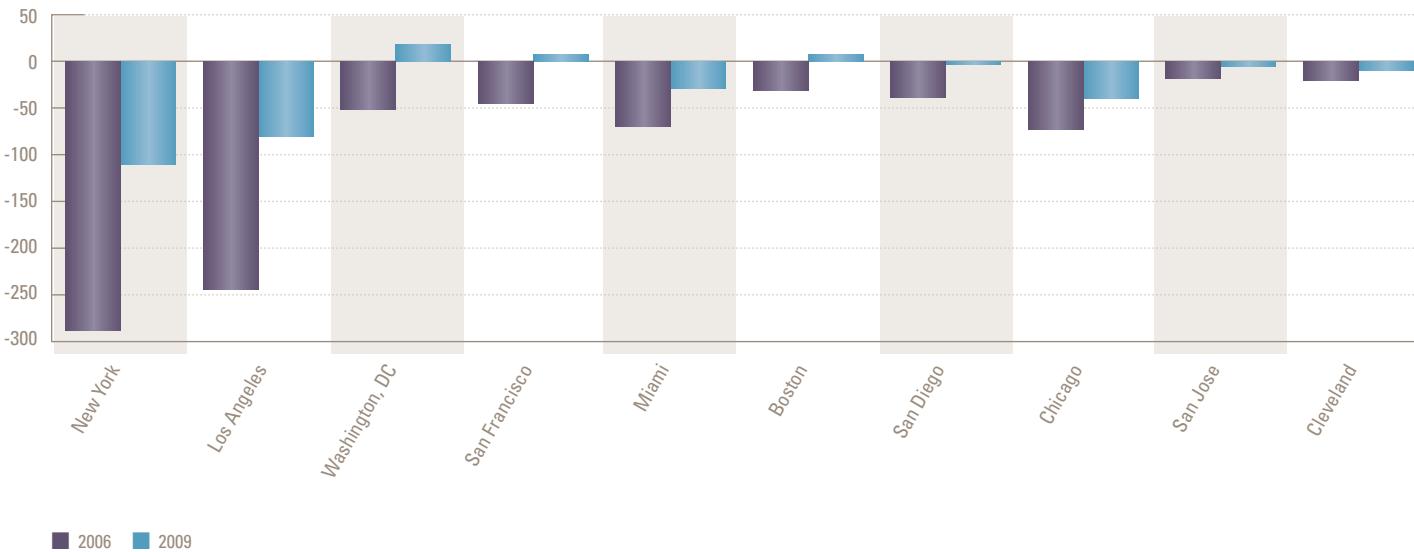
Along with lower mobility, changes in domestic migration may at least temporarily alter regional patterns in home improvement activity. Over the past decade, households have been relocating in significant numbers from the older areas in the Northeast and Midwest to newer areas of the South and West. Topping the list of migration losers over the past decade is New York, which lost 2.0 million persons on net. The top gainer was Phoenix, which added more than a half-million persons on net.

Since the peak in the housing market, however, these long-term trends have changed substantially. Indeed, several traditionally slower-growing or declining metropolitan areas in the Northeast and Midwest, as well as in California, saw

Figure 24

Since the Peak of the Housing Market in 2006, Out-Migration from Metros in the Northeast and Coastal California Has Slowed

Net domestic migration (Thousands)



Notes: Of the 50 largest metropolitan areas in the country, these 10 had the largest increase in net domestic migration in 2009 from 2006 levels. New Orleans is not shown here because of the unusually high rate of in-migration after Hurricane Katrina.

Source: US Census Bureau Population Estimates.

the greatest improvement in net domestic migration between 2006 and 2009. New Orleans posted the largest increase in in-migration as households moved back to the area after Hurricane Katrina. More typically, though, areas that had been on a downward trajectory in terms of net migration began to see something of a turnaround. For example, Boston, San Francisco, and Washington, DC, went from modest net losses to net gains (**Figure 24**). New York, Chicago, and Los Angeles also went from substantial net migration losses in 2006 to only modest net losses in 2009.

Meanwhile, many long-time winners in terms of net migration saw their gains trimmed back significantly. Population gains in such recently fast-growing metros as Orlando, Jacksonville, Las Vegas, and Riverside, came to a virtual standstill in 2009. These areas were among the most overbuilt when the housing bubble burst and therefore have large inventories of unsold new homes as well as high shares of both foreclosed properties and homes with underwater mortgages. Economic growth has also slowed more sharply in these markets in response to the drastic cutbacks in residential construction and their ripple effect on local economic activity.

Remodelers in metro areas along the Northeast corridor and coastal California should benefit from the shift in migration patterns. Areas that have experienced more moderate losses or even gains in net migration typically have higher average household incomes, higher home values, and older housing

stocks—characteristics associated with higher home improvement spending. Once today's housing market problems are resolved, longer-term migration trends may shift back to favor the Sunbelt areas. In the meantime, though, areas where net migration has improved should continue to see relatively stronger remodeling spending.

EMERGING MARKET NICHES

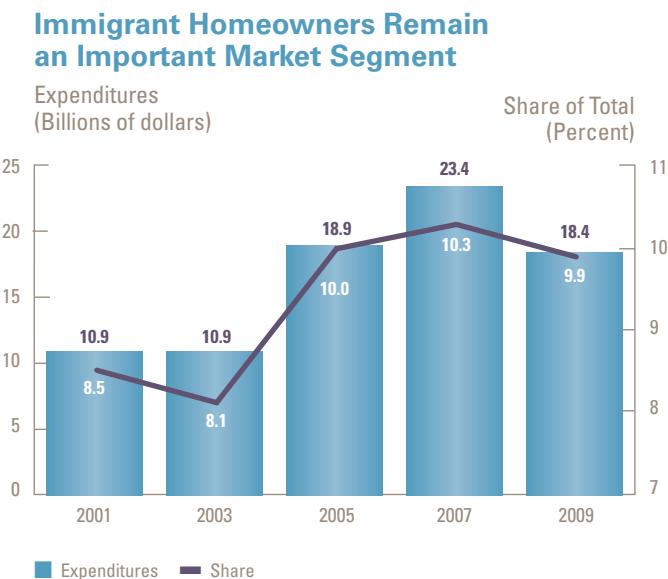
As the economy and housing markets recover, growth in some remodeling segments will be especially strong. Spending by immigrant homeowners is one such category. Between 2003 and 2007, immigrants more than doubled their remodeling expenditures, increasing their share of the overall market from about 8 percent to more than 10 percent (**Figure 25**). But with the national economic recession, net immigration slowed to about 860,000 persons per year between 2007 and 2009, down from about 1.0 million annually in the first seven years of the decade. At the same time, per household spending on improvements fell more among foreign-born than native-born homeowners. As a result, the immigrant share of overall remodeling expenditures dipped back under 10 percent in 2009.

Nevertheless, foreign-born homeowners will remain a vital market for the remodeling industry. Conservatively assuming that inflows are just half of current Census Bureau projections, the Joint Center expects new immigrants to contribute an increasing share of household growth over the coming decades, up from 16 percent in 2005–10 to nearly 20 percent in 2020–5.

Given the concentration of immigrants in urban and suburban locations as well as in the West (37 percent of foreign-born homeowners live in this region, compared with 19 percent of native-born homeowners), any rebound in immigration in the coming years is likely to disproportionately benefit these areas. Immigrant households also tend to be very active in the DIY market. Over the past decade, Hispanic immigrant homeowners in particular were much more likely to take on DIY projects, outspending other immigrant owners by 21 percent and native-born owners by 26 percent.

Green projects provide another important growth opportunity. Results from the JCHS National Green Remodeling Surveys indicate that improvement projects where homeowners specified green features increased from just under 25 percent of all projects in early 2009 to more than 28 percent in the latter part of 2010. The tax incentives for energy-efficient retrofits under the federal stimulus program helped to support this increase. Another factor is that the share of replacement projects and system upgrades—the spending categories that cover a major-

Figure 25



Source: JCHS tabulations of the 2001–9 AHS.

Figure 26

More Remodelers Report Working on Energy Tax Credit Projects

Share of respondents (Percent)



Notes: Building envelope projects include insulation, windows, doors, and roofing. HVAC upgrades/replacements include heaters, furnaces, boilers, and air conditioners. Renewable energy systems include solar, wind, geothermal, and fuel cell technologies.

Percent reporting by project type are tabulated from 2010:3 survey data.

Source: JCHS 2009–10 National Green Remodeling Survey.

Project Types in 2010:3	Percent Reporting
Building Envelope	97
HVAC Upgrades/Replacements	41
Renewable Energy Systems	19

ity of green projects—generally increases during downturns as discretionary expenditures decline. In addition, many homeowners are concerned that home energy costs will climb once economic growth resumes, making energy-efficient improvements attractive investments for the long term.

Energy-efficient upgrades to existing homes offer huge potential savings in terms of national energy conservation. Homes currently account for over 20 percent of national energy usage, and homes built before the 1973 OPEC oil embargo (when energy costs were lower and efficiency was less of a priority) account for about half of the national housing stock. Retrofitting the existing inventory of almost 130 million homes will thus be a massive undertaking.

Remodeling contractors are increasingly targeting energy-related projects and the growth potential that they hold. Between mid-2009 and mid-2010, the share of home improvement contractors reporting that they worked on projects eligible for federal energy tax credits jumped from less than 40 percent to almost 60 percent (**Figure 26**). To date, however, homeowners have focused primarily on smaller-scale green projects that offer a quick payback. Of the general remodeling contractors that reported working on energy tax credit projects in the third quarter of last year, almost all did projects related to the building envelope such as window and exterior door replacements, while fewer than half worked on HVAC upgrades and replacements. Only a small minority installed more expensive renewable energy systems.

With or without federal tax credits, history has demonstrated that market forces can be the most powerful incentive for energy-efficient retrofits. In the years ahead, energy consumption is likely to rise dramatically in rapidly developing countries such as China and India. As American households come to believe that higher home energy costs are inevitable, the perceived payback from retrofits will rise and green remodeling activity will increase.

As the economy continues to improve and the broader housing market stabilizes, remodeling spending should thus return to the average growth rate of the past 15 years. Still, the remodeling market of the coming decade will be different from the one of the past decade, relying less on upper-end discretionary projects to drive growth. Instead, spending on smaller projects—often to replace older features or upgrade basic systems—is expected to increase in share. Growth in the number of households, particularly among those entering their prime remodeling years, will ensure that this nearly \$300 billion industry will continue to capture a large share of housing investment in future years.