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METRO REMODELING MARKETS

With nominal house prices in almost half of the nation's major metropolitan areas back to previous peaks, home improvement spending was up sharply in several high-demand markets in 2015. Upgrades to apartment properties have also given improvement spending a lift, driven by robust rental demand across the country. As the housing recovery continues, remodeling expenditures in several slower-growth markets are expected to increase as the baby boomers modify their current homes to age in place and the millennials buy older, more affordable homes in need of updates.

HOMEOWNER SPENDING TRENDS

Owners living in metro areas spend more on improvements to their homes on average than owners in non-metro areas. But even among the 25 major metro areas included in the 2015 American Housing Survey, remodeling activity varies widely. New York, San Francisco, Denver, Boston, and Washington, DC were the nation's five top-ranked remodeling markets, with improvement spending averaging almost $4,900 per homeowner **(Figure 16).** In contrast, average per owner spending in the five bottom-ranked major metros was just half that amount, or about $2,500.

The large variation in metro spending levels relates to home values and household incomes, both of which are tied to local economic and housing market trends. Median home values are an indicator not only of housing demand but also of the incomes and purchasing power of area residents. As a result, improvement expenditures per homeowner in the five markets with the highest home values averaged more than 60 percent above those in the five markets with the lowest home values.

Metro area incomes are also a large factor, given that higher-income homeowners are likely to spend considerably more on discretionary improvement projects. Indeed, discretionary projects—including kitchen and bath remodels, room additions, and outside attachments such as decks and garages—made up 39 percent of expenditures in the top five metros ranked by income but just 33 percent nationally in 2015. Spending on large projects costing over $50,000 explains much of this difference. These projects accounted for nearly half of all expenditures in the five highest-income metros on average, compared with just over 30 percent nationwide.

But housing affordability is a growing concern in several of today's hot home improvement markets. House price-to-income ratios in the five top-spending metros are significantly higher—and homeownership rates for younger households significantly lower—than in the five lowest-spending metros. An emerging question is to what extent the millennial generation will be able to break into homeownership, and thus into the residential remodeling market, in these pricy areas.

Figure 16

Markets with the Highest Improvement Spending Also Report the Highest Home Values and Homeowner Incomes

Characteristics of Markets Ranked by Per Owner Outlays, 2015

	Top 5 Metros	Bottom 5 Metros	25-Metro Average
Average Per Owner Improvement Spending ($)	4,870	2,450	3,400
Share of Spending on Discretionary Improvements (%)	38	29	34
Median Home Value ($)	448,000	196,000	268,000
Median Homeowner Income ($)	106,000	72,000	83,000

Source: Table A-8.

THE ROLE OF HOUSE PRICES AND HOME SALES

Given that house price trends shape improvement spending, many of the strongest remodeling markets in 2015 were metros where home values had fully recovered from the downturn. For example, prices in Boston, Dallas, Denver, San Francisco, and Portland were among the first to rebound after the crash. As a result, homeowner improvement spending in most of these areas substantially exceeded the 25-metro average in 2015 **(Figure 17).** Meanwhile, house prices in Chicago, Detroit, Miami, Phoenix, and Riverside had only partially recovered from their sharp drop. With their large losses in housing wealth, owners in these areas spent nearly 15 percent less on improvements than the average across all 25 major metros.

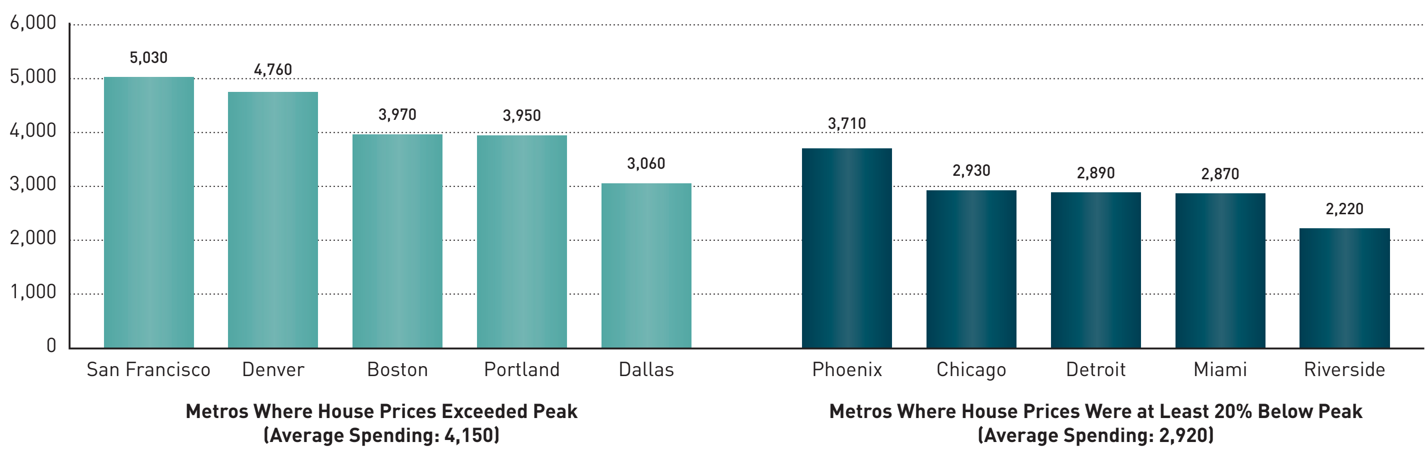
Several other metros with sluggish house price appreciation in recent years also posted more modest levels of home improvement spending in 2015. In particular, the Cincinnati, Cleveland, Memphis, Milwaukee, and Kansas City markets were held back in large part by weaker than average job growth, leaving homeowner outlays more than 15 percent below the major metro average.

Recently, however, existing single-family home sales in several slower-growing remodeling markets have been remarkably strong. Higher turnover of the existing housing stock could signal a jump in improvement spending over the next year. As of the third quarter of 2016, the annual pace of existing home sales was more than three times the national rate in Atlanta, Boston, Cleveland, Charlotte, Hartford, Kansas City,

Figure 17

Owners in Many Metros Where House Prices Have Fully Recovered Spent Significantly More on Home Improvements

Average Per Owner Spending, 2015 (Dollars)



Note: House prices are not inflation-adjusted. Data include the 25 metros covered in the 2015 AHS.

Sources: JCHS tabulations of HUD, American Housing Survey; Zillow Home Value Index for All Homes.

Milwaukee, Minneapolis, Providence, and Richmond. Several of these locations offer older, more affordable housing that could enable millennials and older households alike to move into homeownership. As this occurs, improvement spending in these markets should begin to strengthen.

In contrast, improvement expenditures in certain high-cost markets may soon reach a cyclical peak. For example, annual home sales in Los Angeles, San Francisco, and San Jose were down through the third quarter of 2016. Declining existing home sales were also reported in Chicago, Denver, Houston, Las Vegas, and Miami. As house prices eventually stabilize, the growth in home improvement spending in these areas may also moderate.

SHIFTING DEMOGRAPHIC DEMAND

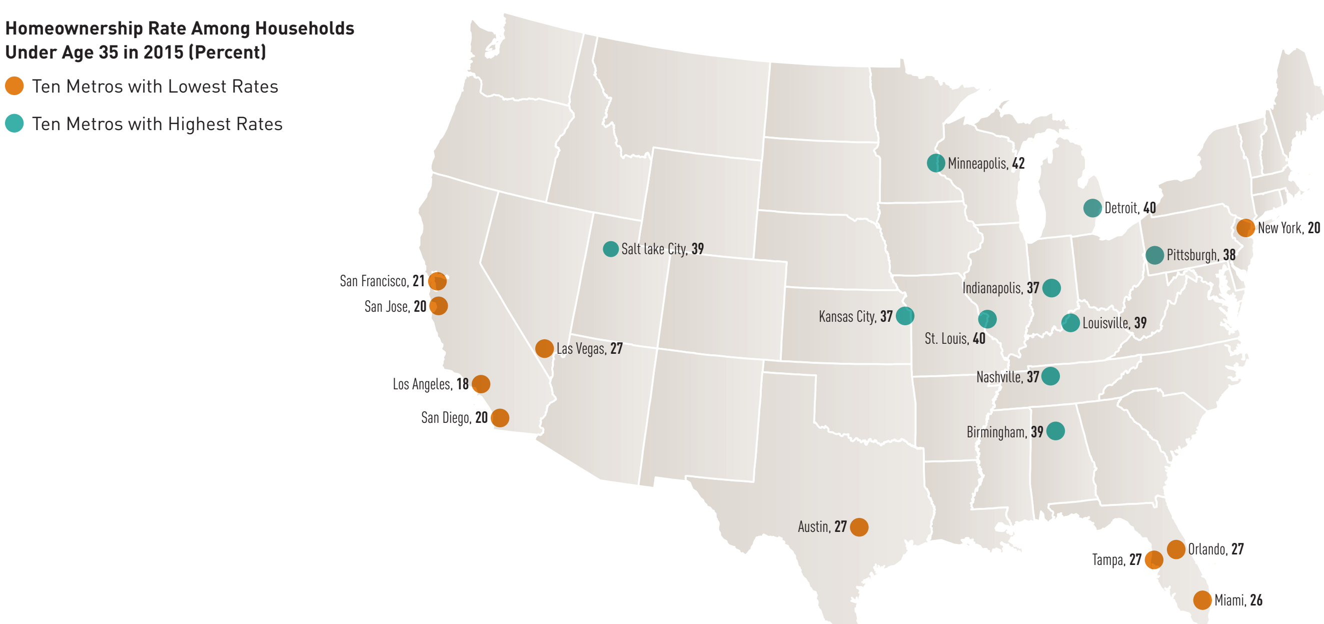
The participation of younger households in the remodeling market will depend on their access to homeownership. While traditionally lower than that of older households, the homeownership rate of households under the age of 35 fell to a 20-year low of 31 percent, according to the 2015 American Housing Survey. In large part, this rate reflects younger adults' lower average incomes and wealth, as well as lifestyle preferences. But it also relates to the affordability of metros where many young adults live and work. Major coastal metros such as Los Angeles, New York, and San Francisco are among the nation's least affordable housing markets, with home prices exceeding incomes by a factor of at least five. In these areas, just a fifth of households under age 35 owned homes in 2015 **(Figure 18).**

Younger households are, however, finding homebuying opportunities in more affordable metro areas of the country. In fact, the homeownership rates for households under age 35 in the ten major metros with the lowest house price-to-income ratios averaged more than 4 percentage points higher than the national rate in 2015. And greater housing affordability enables these owners to invest relatively more in remodeling. For instance, the share of improvement spending by younger homeowners in more affordable markets such as Cincinnati, Detroit, and Kansas City was more than twice that in high-cost markets like San Francisco and Los Angeles.

The nation's stock of lower-priced homes also provides an opportunity for young adults to become homeowners. Among households that bought their current homes between 2012 and 2015, owners under age 35 reported home values that were more than 20 percent below the home values of recent buyers

Figure 18

Younger Households Are Largely Shut Out of Homeownership in Expensive Markets

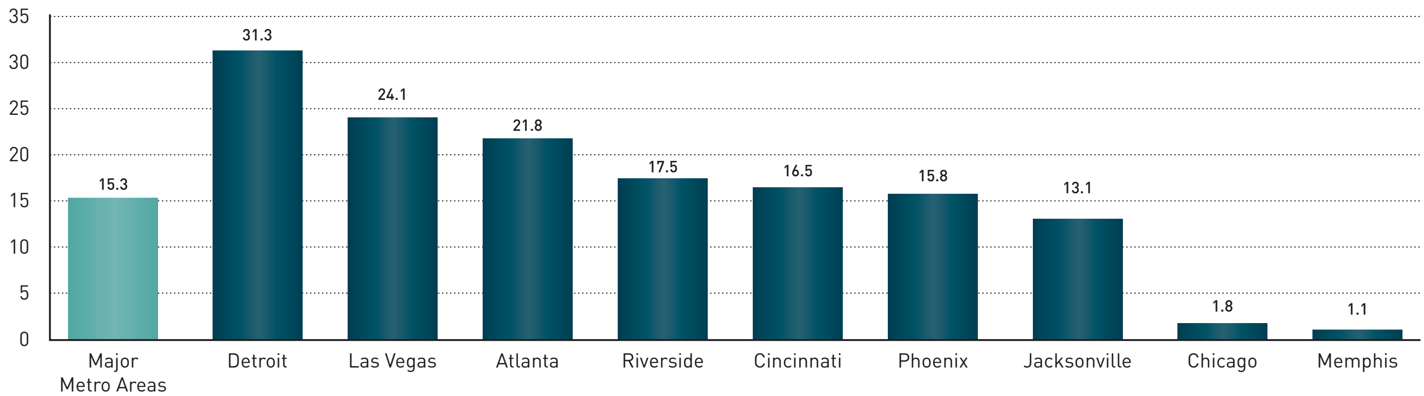


Note: Data include the 50 largest metro areas ranked by population in 2015.
Source: JCHS tabulations of US Census Bureau, 2015 American Community Survey 1-Year Estimates.

Figure 19

Rental Property Owners Invested Heavily in Existing Units in Many Markets Where Multifamily Construction Lagged

Average Annual Real Growth in Per Unit Capital Expenditures, 2010–2015 (Percent)



Notes: Data include garden-style rental apartment properties with 50 or more units and stabilized operations. Growth in capital expenditures is calculated as the simple average of annual rates of change in inflation-adjusted spending in metros with a minimum of 2,000 apartment units and 10 properties sampled.

Source: JCHS tabulations of National Apartment Association, Surveys of Operating Income and Expenses in Rental Apartment Communities; and US Census Bureau, New Residential Construction.

over age 35. In addition, many of the homes bought by younger households were more than 50 years old, with fully a quarter built before 1960.

Younger households are clearly ready to renovate their older homes. Among owners of homes built before 1960, households under age 35 spent 20 percent more on home improvements in 2015 than homeowners age 35 and over. As a result, metros with high concentrations of older homes, as well as strong growth in younger households, are well positioned for growth in improvement spending. Metro areas where the absolute number of homeowners under age 35 increased most in 2014–2015 are scattered across the country and include many relatively affordable metros such as Austin, Charlotte, Detroit, Nashville, and Orlando.

Nevertheless, locations with large concentrations of older adults will also be growth markets for remodelers. While just over half of all owners nationally are age 55 and over, the share of older residents is significantly higher in major Florida markets (for example, Miami and Tampa) and certain Rustbelt metros (such as Buffalo, Cleveland, and Pittsburgh). In addition, older adults make up large shares of recent movers in several Western metros (Las Vegas, Phoenix, and Riverside), where more than a third of owners that moved into their current homes since 2012 were age 55 and over in 2015.

On a per owner basis, households approaching retirement outspent all other age groups in 2015. Metro areas where owners age 55–64 spent at least a quarter more on home improvements include Atlanta, Cincinnati, Dallas, Houston, Memphis, Raleigh, and San Francisco. Although improvement spending typically declines after households reach retirement age, homeowners age 65 and over in Boston, Cleveland, Houston, Pittsburgh, and Seattle spent at least as much as households under age 65—signaling a keen interest in modifying their current homes as they age.

Many studies have shown that most older adults prefer to remain in their current homes as they age. With the ranks of older adults swelling over the next 20 years, demand for universal-design retrofits for improved accessibility will likely surge. The need for home modifications will be especially intense in the Northeast and Midwest regions, where much of the housing stock is older and does not meet basic accessibility standards.

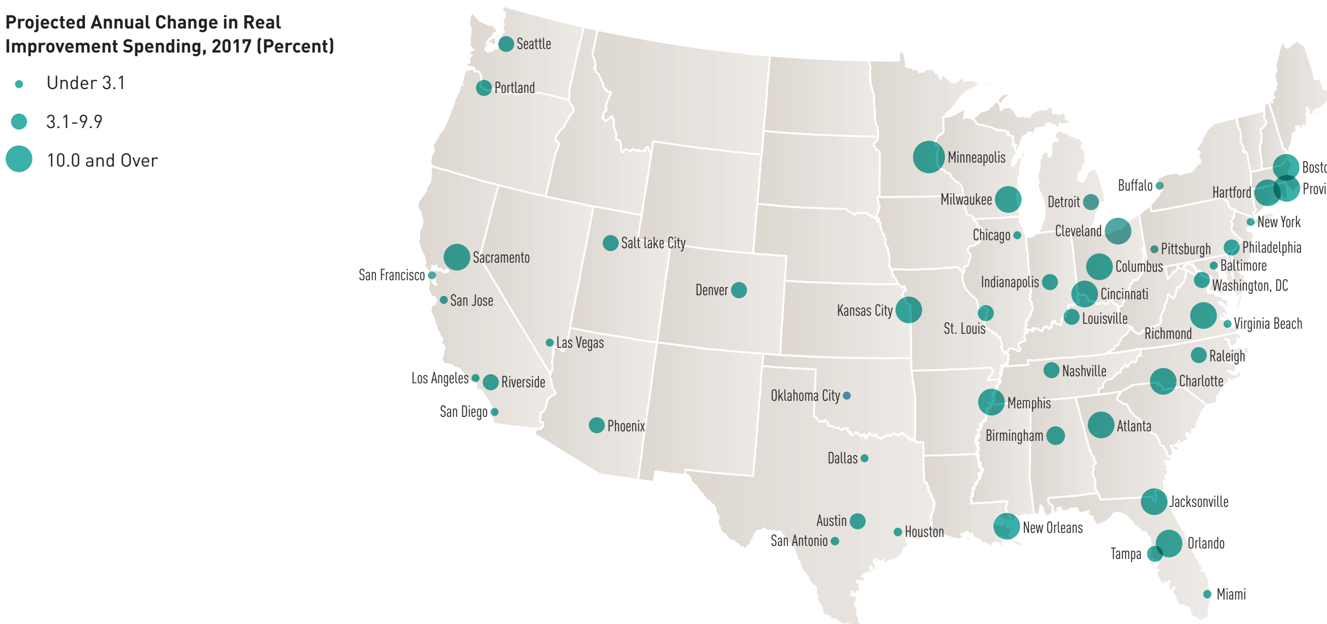
INVESTMENTS IN RENTAL PROPERTIES

Ten million net new renter households were added nationally from 2005 to 2015, according to the American Housing Survey. In response to soaring rental demand, property owners have invested in significant upgrades to their units. Survey data from the National Apartment Association indicate that real per unit capital expenditures for apartment complexes were up 12 percent annually on average from 2010 to 2015.

Growth in rental improvement spending has been remarkably strong in several large markets where multifamily construction

Figure 20

Many Remodeling Markets in the East and Midwest Are Projected to Post Double-Digit Growth This Year



Notes: Data include the largest 50 metro areas ranked by population in 2015. Spending projections are calculated as the average of annual rates of change in sales of existing single-family homes (as of 2016:3) and starts of privately owned single-family homes (as of 2016:4). The average projected annual change in real improvement spending for the 50 metros is 6.8%.

Source: JCHS tabulations of US Census Bureau, American Community Survey; and Moody's Analytics estimates.

is unable to supply affordable rental units. Indeed, many major markets where the recent pace of multifamily construction was well below the annual average over the previous two decades posted substantial increases in capital improvement spending **(Figure 19).** Renovations have thus helped developers and owners meet sharply rising demand for a wide range of rentals.

Property owners typically upgrade their apartments in order to command higher rents. One indicator of the current market opportunity is that annual rent increases for middle-market units (Class B) were outpacing those for lower-quality units (Class C) by more than 2.0 percentage points in the third quarter of 2016, according to MPF Research data. By this measure, investors and owners of Class C units in markets where Class B rents are rising relatively more quickly—such as Los Angeles, Orlando, Portland, Sacramento, Seattle, and Tampa—have a substantial incentive to upgrade their properties to meet growing demand.

NEAR-TERM SPENDING PROSPECTS

Two indicators of housing demand—single-family starts and growth in existing home sales—suggest that home improvement activity should continue to pick up in the majority of the top 50 markets in 2017 **(Figure 20).** Several fast-growing, Southern metros make the list, including Atlanta, Charlotte, Jacksonville, and Orlando, where homebuilding activity has revived and household growth has been strong recently. Conditions in several other affordable markets of the Midwest—such as Cincinnati, Cleveland, Columbus, Kansas City, Milwaukee, and Minneapolis—also favor increased improvement spending.

Strong home sales in major New England markets (Boston, Hartford, and Providence) should also support strong gains in improvement expenditures. In contrast, growth in remodeling expenditures in other major East Coast markets (New York City and Washington, DC) is expected to dip well below the 6.8 percent average pace in the nation's 50 largest markets.

On the West Coast, Sacramento is expected to see a pickup in expenditures, but the leading indicators for Las Vegas, Los Angeles, San Diego, San Francisco, and San Jose all point to a possible leveling off in spending as several of these markets approach cyclical peaks. Metros with oil-based economies, such as Dallas, Houston and Oklahoma City, are also expected to see slower growth or declines in remodeling activity in 2017.

THE OUTLOOK

The outlook for metro markets reflects the diversity of local housing and economic conditions. In general, metros that have the highest home values, and those where prices have reached or surpassed their previous peaks, should continue to post above-average levels of per owner improvement spending in the near term. In other markets where prices are still on the path to full recovery, homeowner spending is expected to increase in step with price gains. At the same time, though, home improvement outlays in metros at or near their cyclical peaks are expected to slow or decline this year.

In metros across the nation, older owners will drive most of the growth in improvement spending over the coming decade, fueling demand for home renovations to meet their changing accessibility needs. But millennial households hold the potential for longer-term impacts. The high cost of housing in coastal markets will encourage many younger households to look for more affordable homes to buy, including older homes requiring renovations. And with continued steady growth in demand, rentals will remain an important segment for the remodeling industry, particularly in high-cost areas where upgrading older buildings would help meet strong demand for middle-market apartments.