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INTRODUCTION AND SUMMARY

Slowly but surely, the US home improvement industry is emerging from its worst downturn since the government began tracking spending in the early 1960s. Homeowners who deferred maintenance and improvements during the recession may soon start to spend more freely. Lower household mobility in the wake of the housing market crash could also mean that homeowners will focus on upgrades with longer paybacks, particularly energy-efficient retrofits.

The industry is also beginning to benefit from spending on the rehabilitation of foreclosed properties. Over the coming years, real spending on homeowner improvements is expected to grow at a 3.5 percent average annual pace, ensuring that the industry captures a large share of the residential investment market.

Remodeling spending peaked nationally in 2007, well after the housing bubble burst but before the collapse of the US financial system sent the broader economy into recession. By Joint Center for Housing Studies estimates, the overall remodeling market—including spending on maintenance and improvements of rental as well as owner-occupied units—fell by 12 percent between the 2007 high and 2009. The peak-to-trough drop in homeowner spending alone was well over 20 percent.

The composition of homeowner expenditures also changed over this period. The share of spending on discretionary projects—kitchen and bath remodels, room additions and alterations, and other interior additions—declined by about three percentage points (from 49 percent to 46 percent) while the share of spending on exterior replacement projects and system upgrades increased by almost exactly the same amount. The share devoted to property improvements and disaster repairs was thus largely unchanged.

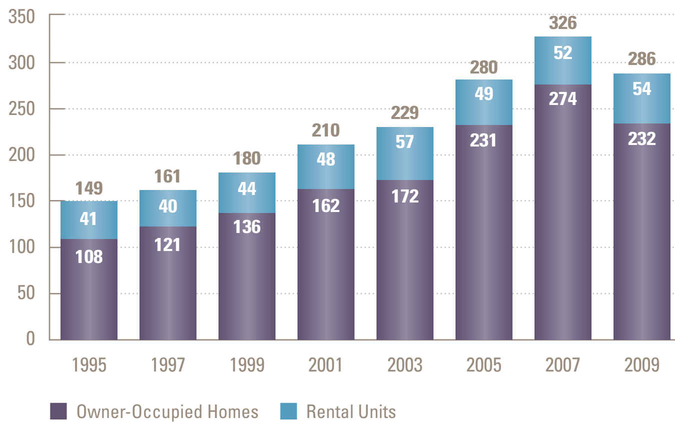
SURVIVING THE CYCLE

At almost $290 billion in 2009, the remodeling market held up much better than new residential construction during the downturn. Indeed, the maintenance component of remodeling expenditures increased slightly in 2007–9—not surprising since this spending category tends to remain fairly stable across cycles.

Figure 1

Even with the Recent Decline, the Remodeling Market Is Nearly $300 Billion

Improvement and repair expenditures (Billions of dollars)

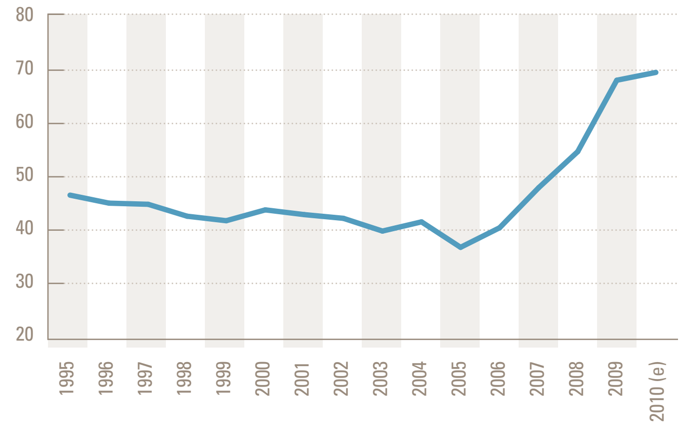


Sources: JCHS tabulations of the 1995–2009 American Housing Surveys (AHS); US Department of Commerce Survey of Expenditures for Residential Improvement and Repairs (C-50); and Abbe Will, *Estimating National Levels of Home Improvements and Repair Spending by Rental Property Owners,* JCHS Research Note N10-2, October 2010.

Figure 2

Remodeling Spending Is Contributing a Growing Share of Residential Investment

Improvement and repair expenditures as a share of total residential investment (Percent)



Note: Total residential investment expenditures include the value of construction put in place for new single-family homes, multifamily homes, and improvements and repairs to owner-occupied and rental units.

Sources: JCHS tabulations of the 1995–2009 AHS; US Census Bureau, C-50 series and Value of Private Construction Put in Place (C-30); McGraw-Hill Construction, Commercial & Industrial Alterations; Bureau of Labor Statistics, Consumer Price Index; and the JCHS Leading Indicator of Remodeling Activity.

Improvements to rental units also increased modestly over this period according to Joint Center estimates. Expenditures by rental property owners have historically been about as volatile as spending by homeowners. During the recent housing market crash and economic recession, however, falling home prices, high unemployment, and record foreclosures discouraged homeowners from making improvements to their properties.

At the same time, a growing share of households chose to rent. This in turn encouraged rental property owners to upgrade their buildings after years of underinvestment. After averaging 2 percent compound annual growth from 1995 to 2007, remodeling spending on rentals continued to grow at this rate in 2007–9 even though overall home improvement expenditures declined. The entire drop in total spending during the downturn thus came from a cutback in improvement projects undertaken by homeowners.

LONGER-TERM TRENDS

The recent downturn notwithstanding, remodeling spending has in general been on a healthy upward climb **(Figure 1).** From 1995 to 2009, the remodeling market nearly doubled in size in nominal terms and was up over 36 percent in real terms, effectively matching the pace of expansion in the broader economy. With the return to modest growth in 2010, the remodeling market likely approached $300 billion.

In recent decades, expenditures on home improvements and repairs have averaged 40–45 percent of total residential investment. However, changes in the remodeling share tend to be countercyclical: when the economy and housing markets are strong, spending on new construction generally grows faster than on remodeling, pushing the remodeling share down. For example, when national housing starts exceeded two million units at the top of the home building market in 2005, the remodeling share of residential investment dropped below 40 percent for the first time in more than two decades.

During housing market downturns, the home improvement share of residential investment rises. When housing markets crashed between 2005 and 2009, the remodeling share thus climbed to more than two-thirds of total residential investment. With continued weakness in construction activity in 2010, particularly in the multifamily sector, the remodeling share of residential investment probably increased further **(Figure 2).**

EMERGING INDUSTRY CONCENTRATION

Despite strong growth in spending through 2007, the residential remodeling industry remained highly fragmented. According to the most recent government census, more than 650,000 businesses received a majority of their revenue by providing remodeling services in 2007, compared with a half-million in 2002. Moreover, this estimate

excludes the large number of part-time, semi-retired, and "moonlighting" contractors reporting gross revenues of less than $25,000.

Self-employed contractors continue to make up a disproportionate share of the industry **(Figure 3).** Two-thirds of all residential remodelers had no employees on payroll in 2007, up from 62 percent in 2002. Even the companies with employees were predominantly small businesses. Half of all general remodeling contractors with payrolls reported less than $250,000 in gross annual revenues in 2007, and 70 percent billed less than $500,000.

Nevertheless, there is evidence of concentration among larger remodeling businesses, especially those specializing in more stable market niches. For example, a growing number of exterior replacement contractors have reached sufficient size to benefit from scale in marketing and lead generation, scheduling, production, and negotiations with building product manufacturers and dealers. Similarly, insurance restoration contractors—who have limited marketing and lead generation needs because they typically work under contract to insurance companies—can focus on establishing larger-scale businesses that operate more efficiently.

Finally, some specialty contracting firms—kitchen and bath remodelers, deck and patio builders, energy-retrofit experts, and outdoor living contractors, among others—have survived one of the worst industry downturns in decades by streamlining their operations and becoming more focused and efficient. Still, the ease of entering and exiting the industry, and the relatively high rate of failures, ensure the industry will remain dominated by small firms and self-employed contractors.

METRO MARKET SHIFTS

Homeowner improvement spending is concentrated among a relatively small number of metropolitan areas. Income and house prices are key determinants of improvement expenditures per homeowner, and high-income households and high-priced homes are typically located in large metros. Indeed, over the past decade the top 10 metro markets were home to just 22 percent of homeowners but accounted for 31 percent of total homeowner improvement spending (defined here as net of routine maintenance expenditures). The top 35 metros were home to 43 percent of homeowners but accounted for nearly 55 percent of spending **(Figure 4).**

Homeowners in metro areas of the Northeast and Midwest, as well as coastal California, have higher incomes and more expensive homes—characteristics that boost remodeling spending. However, metro areas in the South and West have generally seen stronger growth in homebuilding, increasing the stock of homes that need upgrades and improvements. A growing share of homes in Sunbelt metros is also entering the age range (20–30 years old) when homeowner improvement spending is usually strong.

As a result, high-growth remodeling markets have recently been concentrated in key Sunbelt states. The housing bust and subsequent recession, however, have temporarily disrupted regional spending patterns. Of the 20 states with increases in gross domestic product in 2009, only 7 were in the Sunbelt. The traditionally fast-growing states of California, Texas, and Florida all saw major declines in GDP last year. As long as these housing markets remain depressed, the major metropolitan areas of the Northeast and Midwest are likely to gain a growing share of home improvement spending.

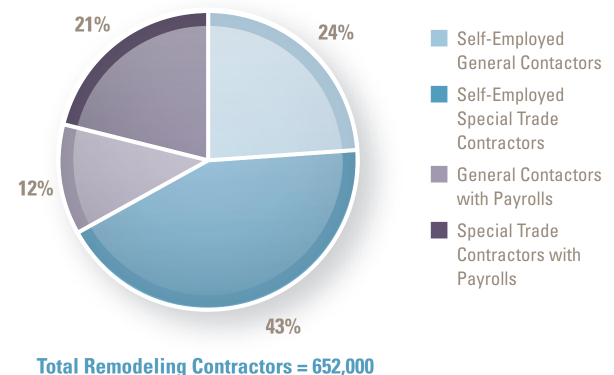
REMODELING IN THE NEW DECADE

The home improvement industry faces several headwinds. House prices have fallen sharply and remain depressed. This has left almost a quarter of homeowners with mortgages in the unenviable position of owing more on their homes than their homes are worth. Furthermore, record numbers of homeowners are seriously delinquent on their mortgages. Under these circumstances, many owners are not in a position to borrow against the equity in their homes to make

Figure 3

Small Nonpayroll Firms Continue to Dominate the Industry

Share of contractors with a majority of revenue from home improvements in 2007



Total Remodeling Contractors = 652,000

Note: Self-employed figures do not include remodelers reporting less than $25,000 in gross receipts in 2007.
Source: JCHS estimates using unpublished tabulations from US Census Bureau, 2007 Economic Census of Construction and Nonemployer Statistics.

Figure 4

Remodeling Spending Is Concentrated in Major Metropolitan Markets

Average annual homeowner spending, 2000–9 (Billions of 2009 dollars)

Seattle, 2.7
Minneapolis, 4.2
Milwaukee, 1.1
Chicago, 7.7
Detroit, 3.7
Cleveland,1.6
Boston, 5.0
New York, 12.5
Philadelphia, 4.7
Pittsburgh, 1.9
Baltimore, 2.2
Washington, DC, 4.6
Virginia Beach, 0.8
Columbus, 1.0
Cincinnati, 1.2
Indianapolis, 1.1
Kansas City, 1.1
St. Louis, 1.9
Sacramento, 2.0
San Francisco, 3.6
San Jose, 1.8
Salt Lake City, 0.7
Las Vegas, 0.8
Los Angeles, 9.6
Riverside, 2.3
San Diego, 2.6
Phoenix, 2.4
Dallas, 2.9
Atlanta, 3.2
New Orleans,1.7
Houston, 2.8
San Antonio, 0.5
Orlando, 1.4
Tampa, 1.6
Miami, 3.3

Top 10
31% of total US spending

Top 35
54% of total US spending

Notes: Metros shown are the 35 largest by population for which AHS data are available. Spending figures are weighted by population, income, age of the housing stock, and structure types.
Source: JCHS tabulations of the 2001–9 AHS.

improvements. In addition, homeowners that are underwater on their mortgages (i.e., have outstanding loan balances that exceed the market values of their homes) cannot move unless they default on their loans or can cover the difference between the sale value of the properties and the amount owed, or the lenders agree to short sales.

This is dampening remodeling activity by reducing home sales and the additional spending that turnover triggers, both by sellers that fix up their homes to put them on the market, and by buyers that make improvements after purchase. In addition, high unemployment rates and weak consumer confidence are causing many homeowners to defer all but the most essential repairs and replacements. Finally, homeownership rates and the number of homeowners have declined. Since homeowners spend more on improvements on average than owners of rental units, the downturn in homeownership is also limiting the growth in remodeling spending.

But looking beyond these near-term constraints, market fundamentals—the number of homes in the housing stock, the age of those homes, and the income gains of homeowners making improvements—point to increases in remodeling spending in the years ahead. Over the long run, the pace of growth in remodeling spending reflects the pace of growth in the overall economy, with homeowners accelerating some of their expenditures during up cycles and deferring projects during down cycles. According to Joint Center estimates, remodeling expenditures accounted for 2.01 percent of total spending in the US economy in 1995 and for an almost identical 2.03 percent in 2009. Between 1995 and 2009, remodeling spending grew at a compound annual rate of 4.75 percent while the economy grew at a similar compound annual rate of 4.71 percent. Even longer-term Commerce Department estimates of improvements to residential structures have closely tracked the growth in the broader economy.

As the economy and the housing market return to more normal conditions over the next five years, so too will homeowner improvement spending. With concern over environmental sustainability growing and home energy costs expected to rise in the years ahead, spending on green remodeling projects in general—and energy-efficient retrofits in particular—should see healthy gains. In addition, immigration is expected to recover, ensuring that foreign-born households account for a large share of net new households. As these households age into their peak remodeling years (mid-30s to mid-50s), they will support further growth in improvement spending.

Predicting remodeling spending in any given year is challenging because the market is so volatile. But average homeowner spending varies systematically with age, race, and household

Figure 5

Homeowner Improvement Spending Should Grow Strongly Over the Next Five Years

Compound annual growth rate (Percent)

Note: Home improvement spending levels used to calculate the compound annual growth rate are in 2010 dollars.
Source: Table A-11.

type, and this variation can be used to make projections given additional assumptions about changes in the number of homeowners and per household spending. Using this approach, the Joint Center estimates that homeowner spending will increase 3.5 percent per year compounded in 2010–15 after adjusting for inflation.

Just under a third of the increase (about 1.1 percent per year compounded) comes from the 4.5 million growth in the number of homeowners expected over this period. The remaining two-thirds (2.3 percent per year compounded) reflects an increase in per household spending. Spending levels per homeowner are projected to rise because of both an increase in household income and a change in the mix of households. In the next five years, growth in the number of households moving into the 55–64 and 65+ age ranges—when homeowners typically prepare their homes for their retirement years by making aging-in-place retrofits—is expected to be particularly strong.

A 3.5 percent annual pace of growth in home improvement spending puts the 2010–15 period squarely in the middle of the past two five-year periods. In 2000–05, spending increased at an unsustainable pace as the homeownership rate was climbing, house prices were soaring, and lenders were quick to make loans for home improvement projects. In 2005-10, conditions were the opposite: the homeownership rate was falling, house prices were down in most markets, and lenders were hesitant to extend credit. As market conditions move closer to normal, home improvement spending should do the same **(Figure 5).**

Obviously the condition of the broader economy, the pace of house price appreciation, mobility rates among homeowners, credit market conditions, and other factors will greatly influence the amount of home improvement activity in any particular year. Nevertheless, the long-term expansion of the remodeling market is an unmistakable trend, and a relatively healthy economy will assure future growth in the industry.