S&P Global
Market Intelligence

Ep. 186 – High interest in home improvement

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Call Participants

ATTENDEES

Kristen Hallam

Scott Hazelton

Unknown Attendee

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You're listening to the Economics & Country Risk podcast from S&P Global Market Intelligence. In each episode, our experts will provide you with the where, how and when to make decisions that transform your business.

Kristen Hallam

Home improvement was at an all-time high during the pandemic when many people were forced to live, work and educate their children under the same roof. What is driving the market now and where is it heading? I'm Kristen Hallam, Content Strategist at S&P Global Market Intelligence and your host for this episode of the Economics & Country Risk podcast.

Joining me to discuss the U.S. home improvement market is Scott Hazelton, Director of Consulting at S&P Global Market Intelligence. Scott, welcome back to the podcast.

Scott Hazelton

Thanks. It's good to be back.

Question and Answer

Kristen Hallam

It's been about a year since we last spoke about this topic, and I'm eager to hear what's changed, what's new. Let's start by talking about what homeownership looks like in the U.S. today. What did the latest census data tell us about the market?

Scott Hazelton

Thanks. It's a great question and actually one that's somewhat counterintuitive perhaps. So we've had increasing homeownership rates in the country for quite some time. And in fact, prepandemic, we had a household ownership rate of 63.4% in 2016 rising to 64.6% in 2019. So we gained 120 basis points before the pandemic.

In 2022, which is the last data available, that ownership rate was at 65.8%. We gained another 1.2%. So you would not think, all things equal through the pandemic, we'd had increase of ownership, we did. And in fact, amongst the youngest demographic of homeowners, those who are under 35, from '16 to '19, we gained 220 basis points. Through the pandemic to 2022, we gained 250 basis points. They actually accelerated the homeownership trend. 35 to 44 was up about 1.5. prepandemic, up 2.1 postpandemic. And then older households tend to be pretty unstable.

But what that means is that on a 6-year basis to now, we've seen a 450 basis point increase in homeownership amongst those under 35 years old. Now their ownership rate is still low. It's only 39% compared to 75% for those in their 50s. But still, that's a very large increase from 34.5% to 39% with the implications for home improvement spend. And that's your youngest demographic who are typically first-time homebuyers starting families, and therefore, looking at a need to improve their home.

Kristen Hallam

So what's driven that change in homeownership, Scott?

Scott Hazelton

Certainly, it is the younger demographic. And those who are 65 and older already are about 39% homeownership so you can't really gain much there. It has to come from the younger demographic.

But I think a couple of things have happened. One is rent deflation has been out of this world during the pandemic. And it remains very high even now. It's coming down a bit, but still high by historical standards. It is literally cheaper to own than rent in many markets if you can get together that down payment. And there are some evidence that what's happened is a bit of a wealth transfer from parents to children to get that down payment together and to get into their house which then, of course, they're going to be charged a mortgage from that point forward. But there, I think, some sort of hand downs to hand up as it were for down payments. And then the financial incentives are to own rather than rent given the monthly cost.

Kristen Hallam

So in the home improvement market, there's a pro segment and there's a DIY segment. I would qualify as maybe barely DIY. Are you a pro or a DIYer, Scott?

Scott Hazelton

Well, I was fortunate that in my high school years, my dad renovated a 1915 farmhouse. So I learned a lot about home improvement for a couple of years. So yes, I will not touch things that involve code like plumbing and electrical. But other than that, I'll handle it. Spent my high school years as a roofer for a couple of summers, so I can even do that, but I will not do plumbing and electrical. Things that can blow up, you don't want to mess with.

Kristen Hallam

Wow. Well, I'll have to invite you to my house some time. I've got a few projects I could show you. But in this current home improvement market, Scott, would you say it's more geared toward the pros or more tilted towards the DIYers? Which is the bigger segment right now?

Scott Hazelton

So in terms of the materials being purchased, it's roughly 2/3 DIY and 1/3 pro, which you think about is there's a lot more simple tasks that you can do to replace things around the house than hiring a contractor to add a whole room or something. However, looking at the growth in the coming year, there's reasonable -- in fact, this year now and into next year, I think the pro market will grow more slowly, in fact, might even contract a little bit compared to the DIY market mostly because of interest rates, which are becoming now a factor in terms of how do you finance a home improvement of any size which is what usually contractors get involved -- or the pros get involved.

Kristen Hallam

The interest rates show no signs of moving down, that's for sure. So what kinds of home improvements are people pursuing? What's on their mood boards at the moment?

Scott Hazelton

We have this very interesting, actually historical problem that the availability of homes to move into is at a record low, all-time low. The supply of inventory at any given monthly rate, new and existing is lowest it's been in history. So while we have high ownership rates, the ability to improve that is getting limited by the number of homes that are available in the market, which means that, like it or not, you may be stuck in your current home either for lack of availability or lack of affordability, which means that the market has morphed a bit from doing the really home additions or for an office or a bedroom or even a deck during the pandemic to now what do I have to do to stay in this house for another 5 or 10 years?

And so we're seeing less focus on new kitchens and new bathrooms which are typical, those are things you do when you buy a home and renovate, to roofing, siding, windows, the things you have to do to stay in a home just as upkeep, that you're going to be there for a while longer, which again, those tend to be more pro markets. We had the pro market down a little bit. There's a lot of support for that. There are very -- kinds of jobs being -- needing to be done in many cases require a pro.

Kristen Hallam

One thing that we were talking about was the influence of the Inflation Reduction Act on the home improvement market. What has been the impact of the IRA, would you say?

Scott Hazelton

It's very important in certain areas this rebates -- the homes rebate program and the High-Efficiency Electric Home Rebate Act which is a long name for I think it's HEEHRA. And those are rebates which you can get up to $14,000 in rebates for certain activities. It is income-tested, so lower income get $14,000. As you move up the income scale, you get progressively less. And of course there are also tax credits available as well.

And you can't mix and match, but you cannot buy something under a rebate and also get a tax credit for it. But if you have a lot of work to do, you could do a rebate for one and a tax credit for the other. And what's nice about the tax credit is that that's been there for a while, but it used to be use it once and you're done. Now you can do use it once every year, so that value of that credit has become much higher.

Now, what these things are best for is anything involving energy efficiency. So certainly replacing existing windows, heating systems. If you get a 35% energy reduction, you can take those tax credits. Off rebates, you can get a heat pump, which is a misnomer. Heat pumps, of course, can be used for cooling and heating, but up to $8,000 for a heat pump. You can buy one for less than that. So you can really get almost a free heat pump if you're at the right income level.

But also there's other rebates for electric stoves, cooktops, ranges, wiring, insulation, ventilation. So there's quite a number of energy efficiency operations that can be applied for. And those are certainly having an impact on the marketplace with -- think about where we look at electricians and plumbers. Those fall into these categories. HVAC and heat pumps oftentimes involve a plumber and electrician, good news there.

And in general, we have a slowing market for major appliances. We bought so many during the pandemic that -- especially things like freezers, we are pretty well stocked on those for the next decade or so. But these incentives for electric stoves and other cooking devices will certainly shore up that piece of the home appliance market.

Kristen Hallam

Interesting. I wonder what ripple effects that might have on the supply chain. Certainly, there were some supply chain impacts from all the demand we saw for the appliances.

Scott Hazelton

Those are improving. In fact, there is certainly disruptions remaining, but lead time for most home improvement products is down substantially. Now there are certainly problems in certain spots. But if you think about things like the price of home materials, which was once a stumbling block to home improvement, that's now improved quite a bit.

Levels are high, but the rate of increase is actually in many cases 0 or deflating. Lumber prices actually are down compared to where they were in 2021. The supply chain for building materials has largely unwound itself now that the problem is coming from the affordability side rather than -- as opposed to availability.

Kristen Hallam

So some good news for people looking at home improvement projects, at least on the materials cost and supply chain front. But those high interest rates and generally elevated costs are still with us, it sounds like.

Scott Hazelton

Right. The story a year ago was supply chains and inflation and I think availability of the contractors. That's changed. Certainly, it's still tough to find contractors. Wait times are still appreciable to get somebody on a job. But the problem now is the financing. So if it's a big job which -- and you can't get the IRA tax credit, you're looking at 8% mortgage interest rates probably through most of 2024.

And you can take out a loan on your home certainly. The home prices have stabilized in most markets. That's good news. Your financial transactions have been somewhat muted. The stock market has been down. It's improving once again. The asset picture for households is lower than it was a year ago, but still relatively strong.

The problem is affordability. If you're trying to finance it and your credit card debt is at an all-time high as well. So even for smaller jobs, there's limits on some households as to how much more debt they can take on.

Kristen Hallam

So looking ahead to the next six months to a year, what factors would you say are going to be influencing the market? Is it going to be some of these things that we were just talking about, like inflation and supply chain? Or will it be labor costs and material costs or something that we haven't touched on yet? What do you think, Scott?

Scott Hazelton

Well, I mean inflation in the sense that overall inflation in the economy impacts the Federal Reserve and its monetary tightening or not. But materials inflation itself in building materials will not be the problem. The bigger problem now is labor cost, which is endemic in the economy, including with contractors. And until the Federal Reserve eases, we're not going to see that reduction on mortgage rates, and therefore, home improvement loans for some time. And realistically, it takes time for that to work its way through the economy.

The Fed probably won't act in our judgment as a company until sometime in 2024. And it has to work its way through the chain of various rates. So we're looking at next year, the problem being the cost of financing these improvements.

And then we'll also just say that consumer confidence is improving but still relatively low if you have a relatively high cost of interest and a historically low degree of confidence that you don't take out that major loan for the project. So that sort of consumer reluctance combined with the higher rates is going to be, I think, the problem for both DIYers and pros for next few months.

Kristen Hallam

And it's interesting that you mentioned labor costs there too. I'll just flag for our listeners that we're planning an episode on the labor market, so stay tuned for that.

Scott, what would you say are the top 1 or 2 takeaways from this conversation? We've covered a lot of ground here, but what are the main messages we should leave our listeners with today?

Scott Hazelton

That if you're a home materials supplier, strongest piece of the market will be the DIY, we think, for the next 12 to 18 months. That the cost of improvements, if it's done through financing, is going to be a hindrance. But if you're involved with electrical equipment, HVAC, those kinds of materials with incentives from the IRA, advertise those because the cost of some of these improvements can be near 0 when you get done with the rebates and the tax credits.

So if you can't get the interest from the desire to improve one's house just for the sake of living comfort, you can get it from a standpoint of saving energy down the road at very low cost today.

Kristen Hallam

Well, thank you, Scott, so much for coming back to the podcast and sharing your insights with us on home improvement. We'll have to make this an annual tradition maybe. And thanks to our listeners for joining us. Let us know what topics you want us to cover by interacting with us on the S&P Global Market Intelligence social media handles. And join us next week for a discussion of Russia's economy.

Unknown Attendee

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