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REPAIR AND REMODEL 2023 MARKET OUTLOOK

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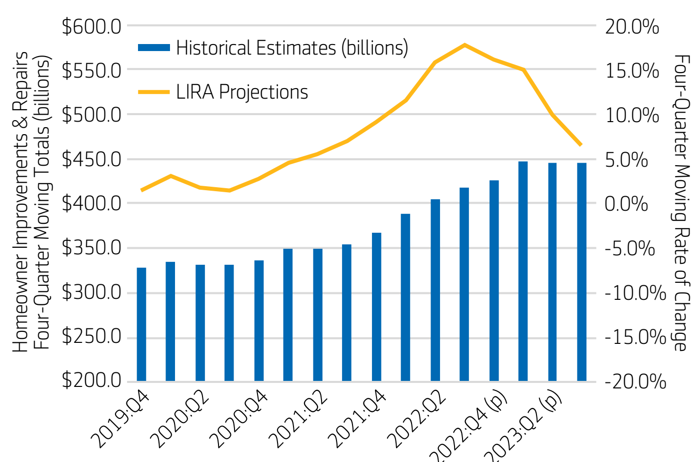
The housing slowdown will most likely have an effect on repair and remodel (R&R) markets. However, the impact isn't expected to be as severe as new residential construction, supported by a variety of leading indicators, the non-discretionary nature of some products, aging housing stock, and high levels of home equity.

According to the Leading Indicator of Remodeling Activity (LIRA) put together by Harvard University's Joint Center for Housing Studies, R&R spend has climbed from 9.1% to 17.8% on a trailing four-quarter basis for each of the last four quarters, which is well above the long-term average of roughly 5%. The strong increase in R&R spend isn't surprising given how the R&R market has historically performed in relation to the housing market. Going back to data from 1970, R&R downturns have typically mirrored the housing market but have been more resilient as they were shorter and less severe. The reason R&R spend is typically less cyclical than the homebuilding market is that nearly 70%-75% of R&R spend is in non-discretionary, more inelastic categories of R&R (roofing, plumbing, HVAC, etc.).

For 2023, the LIRA is projecting R&R spend to be 6.5% (exhibit 1), which is a significant deceleration from 2022 levels but is notably above the average long-term growth rate. One item to note regarding the LIRA is that it isn't designed to reflect or account for a potential pull forward in demand which may have occurred during the pandemic, so there is a risk the model's outlook is overly bullish; however, that risk factor doesn't change our overall thesis of a resilient R&R market in 2023. Moreover, the National Association of Homebuilders' Remodeling Market Index also paints a relatively resilient picture of the market. In the third quarter of 2022, the index reading came in at 77, which is down from its peak of 87 in the third quarter of 2021, but still well above 50 (any number above 50 indicates growth). Both indicators paint a similar story of a sharp deceleration, but a still relatively resilient market.

Exhibit 1: Leading indicator of remodeling activity, third quarter 2022



Notes: Historical data through 2019 are JCHS estimates based on American Housing Survey data. Historical estimates since 2019 are produced using the Leading Indicator of Remodeling Activity model until new AHS benchmark data become available. Projections (p) are produced by the LIRA model. Improvements include remodels, replacements, additions, and structural alterations that increase the value of homes. Routine maintenance and repairs preserve the current quality of homes. Source: Joint Center for Housing Studies. As of September 30, 2022.

Some of the main headwinds that are likely to impact the R&R market are slowing home sales as housing mobility can drive demand, rising costs of project financing and labor/materials, and fears of an economic recession. While these headwinds are notable, they are most likely to impact discretionary categories of R&R which only make up 25-30% of total R&R spending.

The two most meaningful tailwinds are high levels of home equity in the US, and the continued aging of the US housing stock. Homeowner equity levels are important because it is generally a significant source of funding for R&R projects. Current home equity as a share of household real estate is 71%, which is comfortably above the long-term average (1970-present) of 63%. The average homeowner gained $34,300 in equity in just the last year according to CoreLogic. Even if national home values decline in 2023—which is a possibility—the declines would have to be roughly 20% to bring homeowner equity levels down to the long-term average.

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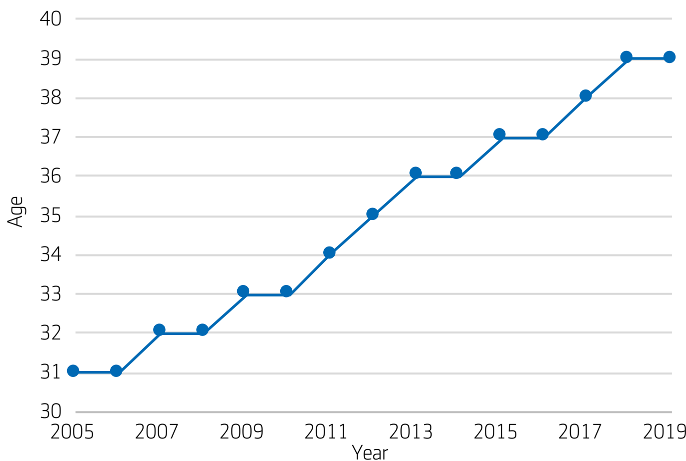
Historically strong levels of home equity should continue to provide a healthy source of funding for R&R projects and continue to be a positive driver for the market.

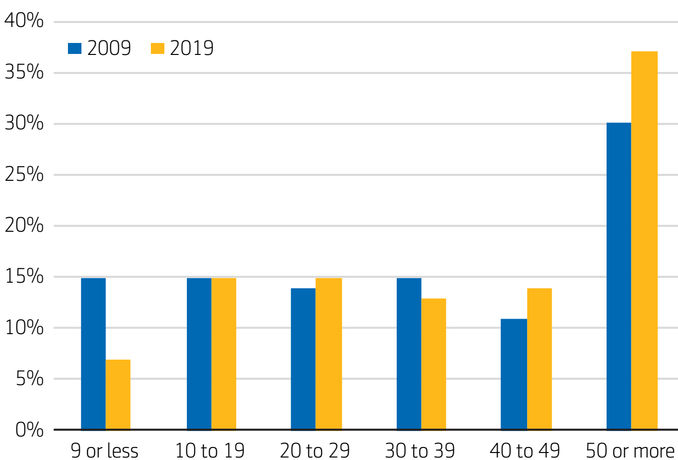
Another tailwind, and one that can be viewed as more secular in nature, is the aging housing stock in the US. Exhibits two and three display data on the age of the owner-occupied US housing stock.

Exhibit 2: Median age of owner-occupied housing



Source: American Community Survey Estimates. As of December 31, 2019.

Exhibit 3: Age of owner-occupied housing stock 2009 versus 2019



Source: National Association of Home Builders. As of December 31, 2019.

The data illustrates the median age of homes has meaningfully increased over the last 15 years, and an increasing share of the housing stock is segmented into categories of older homes. As homes age, there are certain components of the home that need to be repaired/replaced, regardless of the state of the broader housing market or the general economy. The aging housing stock should continue to be a driver of non-discretionary R&R spend in both the short and long term.

As we begin 2023, sentiment surrounding residential construction continues to be weak, and a lot of investors fear what that portends for companies that sell building materials/ supplies used in single-family home construction. While there will be companies who are likely to be negatively impacted by the downturn in homebuilding, given the relatively resilient outlook for the R&R market, it's worth identifying companies in the building materials space that derive a significant portion of their sales from non-discretionary R&R activity, as those companies will likely outperform the broader sector in 2023. We are also constructive on the home improvement retailers for similar reasons.

Sources

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