KPMG

Leveling expectations

As housing market sales and construction slow, the construction market may turn to repairs and renovations as an engine of growth. But what are the pockets of opportunity in this space?

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Executive summary

As high interest rates decrease demand for housing and dampen homebuilders' appetite for new developments, building materials manufacturers and construction companies are preparing for a mix shift away from new construction and towards repair and renovation (R&R) work. However, not all R&R work is equal—a large proportion of it is positively correlated with home sales, as homeowners invest in upgrades before or after the sale.

To understand the drivers of resilience in the R&R market, Dodge Construction Network[1] surveyed 30,685 homeowners across the U.S. to understand project delay and cancellation dynamics, and challenges faced by project type. In collaboration with Dodge Construction Network, KPMG is pleased to share defined insights from this research.[1]

The findings highlight that materials shortages and price increases had a minor impact on R&R project completions in 2021. Furthermore, homeowners seemed to rate those challenges as less severe than home builders, suggesting they were less likely to influence R&R decision making and spend.

There are likely to be pockets of opportunity in R&R for unplanned projects, alterations, and interior work; and among higher valued home in suburban and rural settings, as these areas logged the highest on-time completion rates.

Looking ahead, demand levels may not match the pandemic-driven spikes, but the consensus view among industry associations point to sustained demand for R&R overall. There may be down-trading in quality (or to DIY) as consumers experience inflationary pressures on their overall wallet.

[1] Dodge Construction Network is a technology-driven construction data, analytics, and insights provider. Dodge provides trusted market intelligence that helps construction professionals grow their businesses, and is redefining and recreating the business tools and processes on which the industry relies. In collaboration with Dodge Construction Network, KPMG is pleased to share defined residential data that provides insight in the development of this market perspective.

Renovations are not anticyclical

While there may be a perception that R&R increases in economic downturns, the overall home improvement and repair market traditionally tends to have a positive correlation with home sales, though delayed, per the analyses of the Joint Center for Housing Studies (JCHS) of Harvard University.[2]

The JCHS also publishes a Leading Indicator of Remodeling Activity (LIRA), which calculates based on correlations of market variables to remodeling spend. The top correlated variables with a one quarter lead are Retail Sales of Building Materials, Home Price Index, Leading Economic Index (see exhibit 2 below, additional variables have high correlation with a 4+ quarter lead). These are all positively correlated, meaning that an increase in the Leading Economic Index (for example) typically signals an increase in Remodeling activity about one quarter later.

This positive correlation may be driven by the over 30 percent of R&R spend considered discretionary (including kitchen and bath remodels, room additions, and outside attachments). In weaker economic times, or with declining home prices, home owners may be less willing to invest in discretionary R&R.

As rising interest rates are cooling the home sales market, JCHS projections of renovation activities have dropped. They remain (at time of publication) higher than 2020/21 levels, but quarter-over quarter gains have eroded. There tends to be at least a one-quarter lead between housing sales and R&R activity, so we will continue to monitor the evolution of the home sales market.

Exhibit 1. Renovations (homeowner improvements and repairs)

R&R expenditures in $ billions (home owners and rental property owners)

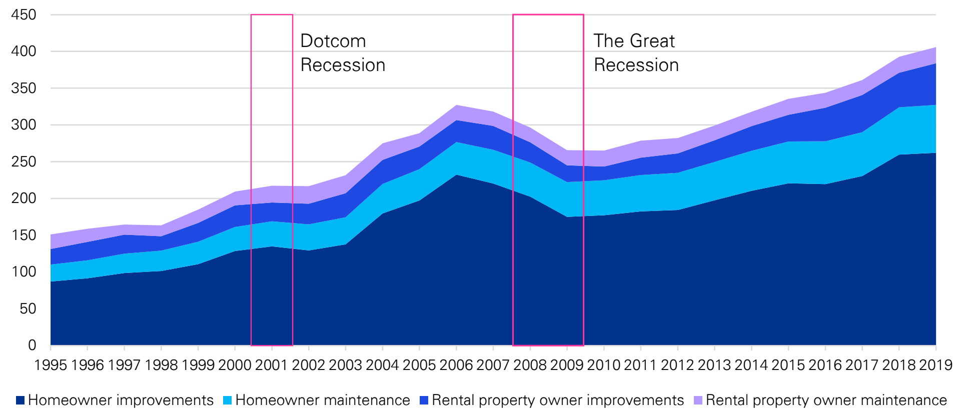


Exhibit 2. Correlation coefficients with AHS-based home improvements spending, one quarter lead

1	**Retail Sales of Building Materials**	**Retail**	**0.8176**
	Source: US Census Bureau, Retail Trade Report		
2	**Home Price Index (HPI)**	**HPI**	**0.7960**
	Source: S&P CoreLogic Case-Shiller HPI		
3	**Leading Economic Index (LEI®)**	**LEI**	**0.7290**
	Source: The Conference Board		

(All with a single quarter lead)

[2] Joint Center for Housing Studies of Harvard University, https://jchs.harvard.edu/research-areas/remodeling/lira

Which renovations will drive building materials sales?

A significant portion of R&R demand over the last few years has been driven by homeowners looking to upgrade their existing homes (in addition to those interested in renovating before moving into a new home). Anecdotally, we heard about (and experienced) shortages of materials and labor that led to project delays and cancellations, and expected to see pent-up demand for building materials in 2022–2023, as projects came back online.

Instead, our survey of 30,685 home owners indicated that **75 percent of renovation projects were completed on time** despite the rollercoaster conditions of the past few years. This varied slightly by job type, with projects more likely to be completed on time including:

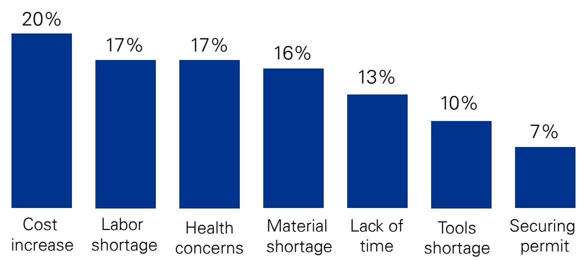
Exhibit 3. Renovation projects completed on time (by job type)

81%	Unplanned projects including emergency repairs	vs.	Planned work	71%
75%	Alterations	vs.	Additions of footprint to the home	68%
76%	Interior work	vs.	Exterior work	69%
77%	Higher valued homes	vs.	Lower valued homes	72%
77%	Suburban/rural	vs.	Urban	71%
78%	DIY[3]	vs.	Contractor performed[3]	74%

Incidence of delays did not show statistically significant differences across U.S. regions. When asked about the challenges faced to complete their work, about half of homeowners reported no challenges at all. But among those who did experience challenges, cost increases loomed larger than material shortages, with labor shortages and health concerns also among the top reasons cited.

Exhibit 4. Challenges faced by homeowners in completing their R&R work

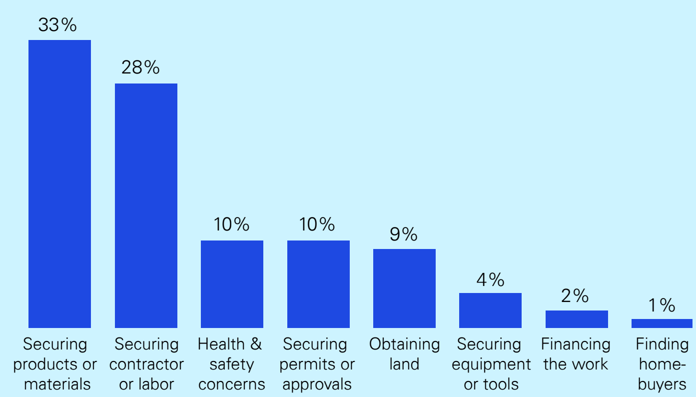
Composite score (n = 21,928 who completed R&R work in 2021)[4]



We also surveyed 325 homebuilders to understand the challenges they faced in 2021. Materials and labor shortages were ranked as a much greater challenge for homebuilders than for homeowners; reflected in the much higher composite score of those two challenges (see exhibit 5).[4]

Exhibit 5. Challenges reported by homebuilders

Composite score (n = 325)



[3] Only asked of respondents completing work on flooring, windows, and patio doors.

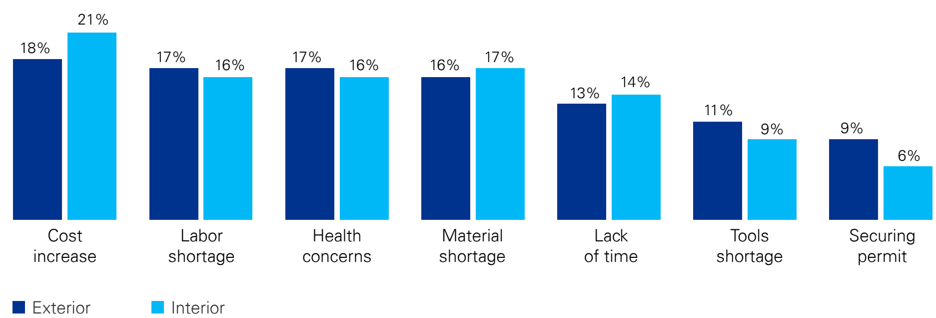
[4] For each option in the ranking question, the highest weight was applied to the most important rank (1) and lowest weight applied to the least important rank (8). The weights were then summed across all respondents for a composite score that could then be ranked to assess the most important issue and least important issue in 2021.

Digging into the survey results:

Homeowners who conduct interior R&R projects reported more frequent cost increase challenges than those who conduct exterior work.

Exhibit 6. Challenges reported by homeowners undertaking R&R – by exterior versus interior

Ranked in top three only

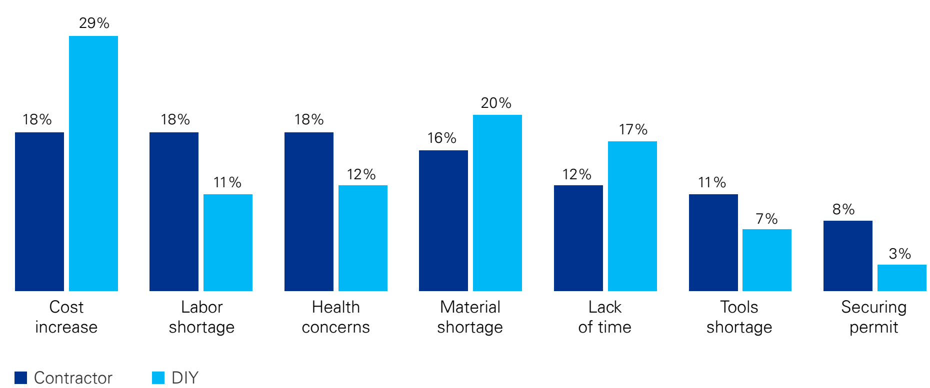


DIY-ers are much more likely to report cost increases as a top challenge, as well as materials shortages and lack of time.

Conversely, contractor-performed work was more likely to face challenges due to health concerns and labor shortages, as well as tools shortages and securing permits. This is understandable, given that many of these concerns would not apply to DIY efforts.

Exhibit 7. Challenges reported by homeowners undertaking R&R – by contractor versus DIY

Ranked in top three only



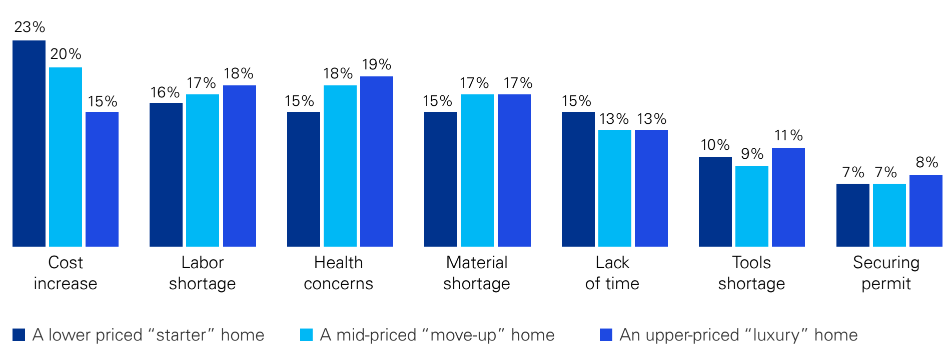
Cost increases were cited as a top ranked challenge for lower priced “starter” homes more often than more expensive homes.

Labor shortages and health concerns appeared to increase in impact as home prices increased.

Materials shortages, time, tools, and permit impacts did not appear to vary based on home values.

Exhibit 8. Challenges reported by homeowners undertaking R&R – by home value

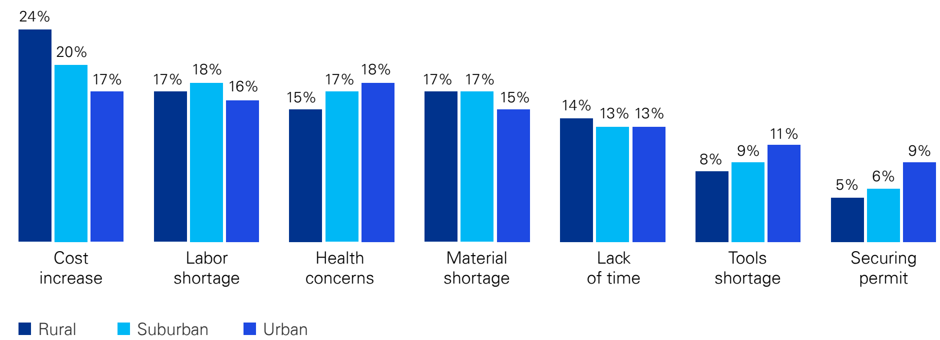
Ranked in top three only



Rural owners were most affected by cost increases, while urban homeowners reported health concerns more often as a top concern (tools shortages and permits remain among the least cited concerns).

Exhibit 9. Challenges reported by homeowners undertaking R&R – by home setting

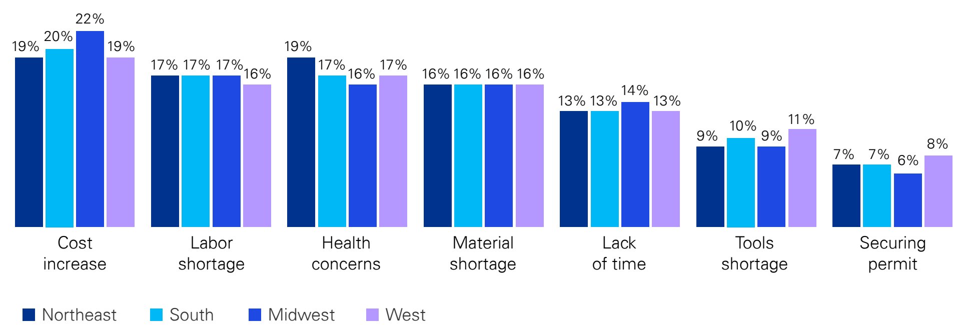
Ranked in top three only



Across regions, the challenges encountered were remarkably consistent, with slightly higher cost increases reported in the Midwest and South, and slightly higher health concerns reported in the Northeast.

Exhibit 10. Challenges reported by homeowners undertaking R&R – by U.S. region

Ranked in top three only



Cost increases are likely to continue into the future as the renovator's top challenge because supply chain snarls and raw material cost increases show little sign of abatement. These challenges, combined with overall inflationary pressures and fears of a recession, may cause homeowners to cut back on discretionary R&R spend, including canceling, delaying, or down-trading demand. This dynamic, however, is pitted against the continued housing shortage, which may lead homeowners to upgrade their properties when they are unable to "up-trade."

Is it time to step off the gas?

The slowdown of new home construction and R&R will release pressure from many building materials companies that have been operating in "over-demand" mode for the past two years. However, building material companies vary in both their exposure to new residential building versus renovation, and how discretionary their products are. The slowing market begs the question: how much do you step off the gas, and where?

KPMG has developed a suite of approaches to help companies:

- **Forecast market performance** based on macroeconomic leading indicators to understand likely growth rates by segment, geography, and product categories
- **Undertake a demand fitness diagnostic** to identify opportunities to reallocate manufacturing capacity and inventory across business lines and channels to better meet the evolving market demand
- **Identify demand "tipping points"** where pricing and promotional strategies could drive share gain—or cause share loss—as a result of competitive positioning

Through these efforts, we have helped our clients derive benefits in multiple areas, including revenue generation, cost control, and working capital optimization.

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Serena helps clients design and execute winning growth strategies to get and stay ahead of market disruptions—including the ups and downs of the homebuilding and home renovation cycles. She works with clients across the construction value chain, with a focus on building materials manufacturers. As the U.S. lead for Deal Advisory and Strategy in construction, she supports clients with both organic and inorganic paths to growth.

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Matt works with clients to design, execute, and realize performance transformation objectives inclusive of cost structure re-alignment and strategic growth initiatives. He has experience across the construction value chain both as a consultant and as an operator with a national homebuilder—he led its transformation with a focus on operational efficiency improvements and a streamlined product offering that led to gross margin increases.