MARCH 2016

Improving America’s housing stock, one loan at a time.

Home improvement spending keeps the U.S. housing stock up-to-date and adequate to the needs of a changing population. Many home improvement and maintenance expenditures are small and paid for out-of-pocket, but large projects tend to be financed through cash-out refinances or home equity loans. With many millions of homeowners “underwater”, this source of credit has been limited, but as house prices rise, home improvement lending should rise in tandem. Given strong house price appreciation this year, we expect home improvement lending to increase by at least $5 billion in 2016 relative to 2014.

Trading up—and down—is a time-honored feature of homeownership. Young couples scrape together a down payment for a modest starter home. As their families expand and their careers advance, they trade up to a larger home, maybe more than once. When the children grow up and leave home, the homeowners often look to downsize to a more-easily maintained house.

However, in the today’s market, demand for houses outstrips the supply of existing homes for sale. Growing families may find themselves stuck in houses that are too small, and older homeowners may not be able, or willing, to downsize. In these circumstances, home improvement projects may provide a solution. Cramped families may be able to add a room or two, while retrofitting may allow seniors to age in place.

In fact, spending on home improvement recently has reached levels not seen since the housing boom of the mid-2000s. According to estimates from the Joint Center for Housing Studies at Harvard University (JCHS), total home improvement spending has been rising recently. The Leading Indicator of Remodeling Activity (LIRA) produced by the JCHS tracks total expenditures on home improvement.[1]

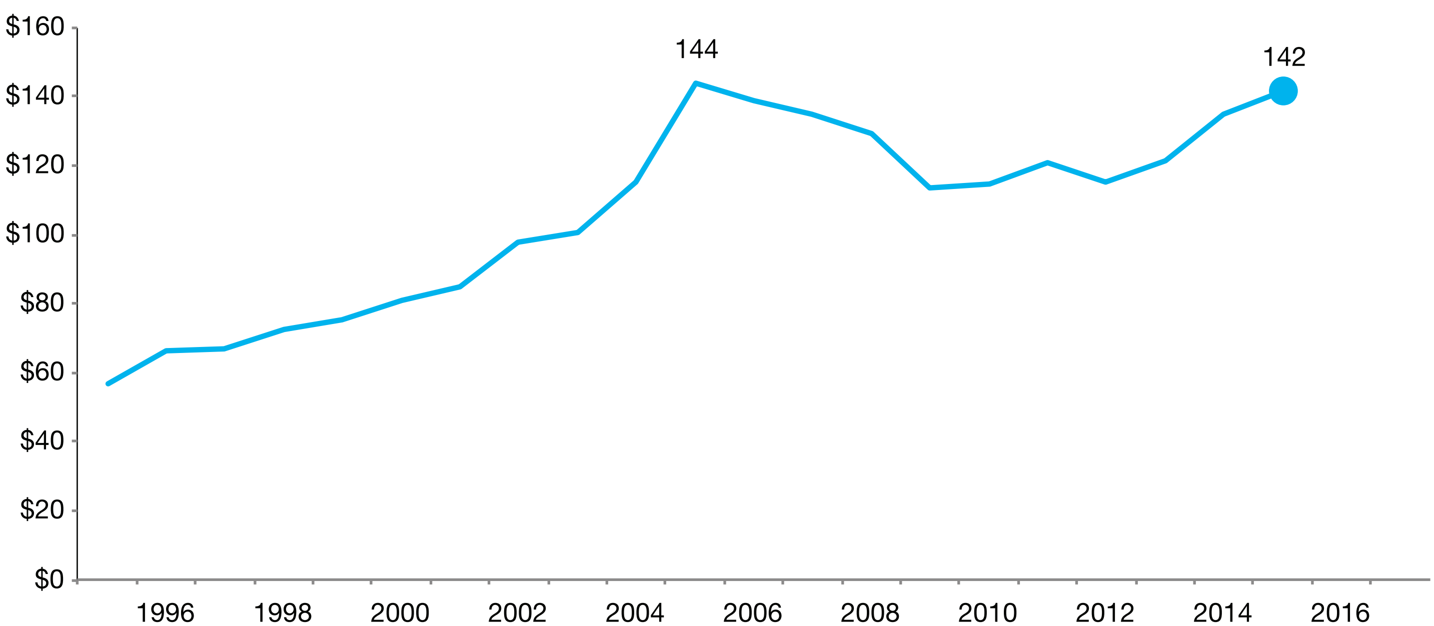
1 The LIRA uses the Department of Commerce’s *Value of Construction Put in Place* series, also known as the C-30, to project the value of residential improvements in the U.S. According to the Department of Commerce, home improvements are defined as remodeling, additions, and major replacements to owner-occupied properties after the completion of the original building. It is important to note that the C-30 does not capture homeowner spending for painting and landscaping, nor routine maintenance and repair work.

The LIRA shows (Exhibit 1) that total annual expenditure on home improvement in 2015 was $142 billion, just a little below the $144 billion spent in 2005. Moreover, home improvement in 2016 is projected to increase over 7 percent on a year-over-year basis topping the previous peak in the mid-2000s. In contrast, while lending for home improvements also will increase, it should remain well below the mid-2000 levels.

In the sections below, we review the reasons for home improvements and the types of projects homeowners expect to undertake. We also document the ways homeowners finance these projects. Not surprisingly, they pay cash out of current income and savings for smaller tasks but take out loans for larger projects. Finally, we highlight the reasons for the projected increases home improvement spending and lending.

EXHIBIT 1

Home improvement spending ($ Billions)



Source: Joint Center for Housing Studies, Leading Indicator of Remodeling Activity and U.S. Census Bureau, Value of Private Residential Construction Spending Put in Place (C-30).

Types of home improvement projects

A lot of home improvement spending is simply maintenance. Houses deteriorate. Paint flakes, stairs sag, roofs wear out, dishwashers break (usually during large dinner parties). Based on a recent study by the Joint Center for Housing Studies of Harvard University[2], $75 billion (26 percent) out of the $298 billion total spent on home improvement and maintenance projects in 2013 were owner or renter maintenance, with the remaining $223 billion being improvement projects. Of home improvement projects undertaken by homeowners, about 17 percent of the dollar expenditure was on do-it-yourself projects with the remaining projects involving professionals.

As we noted above, homeowners with growing families may choose—or be forced—to expand or enhance their existing home rather than to move into a larger home. Just as investing in an older car can put off a new car purchase, home improvements may be a better use of funds than moving to a newer home.

In a previous article, we highlighted how the housing choices made by the 55+ population have a major impact on the future of the housing market. This is especially true for the home improvement industry. While some aging households will look to move into homes that are better suited to their needs, many others will choose to remain in their current homes and communities and “age in place.” Retrofitting a home to their changing needs may make it possible to age in place comfortably. Older homeowners account for a large share of home improvement spending, nearly $90 billion in 2013, and the increasing number of households aging in place will drive up home improvement volume.

However, not all retrofits are for aging in place. Additions and retrofits could be used to turn a single-family home into a multi-generational home, where three or more generations live under one roof. This is an increasingly more common arrangement as the economic realities of rising home prices, tight supply, and stagnant wages makes this a financially smart option. It is a trend fueling renovation projects nationwide. Examples of making a home multi-generational are widening doorways, creating separate spaces for kids and adults, counters at multiple heights, or light dimmers. As more people spend money on making their home multi-generational, this will drive up home improvement volume.

At the same time, rising house prices are bringing more homes to the market and increasing sales, which is a large driver of home improvement activity. In certain cases, newly purchased homes may require repairs or desired upgrades. While many home improvement projects are funded from available resources (cash, savings, etc.), some lead borrowers to open new, or draw against an existing Home Equity Line of Credit (HELOC), or originate a loan specifically for home improvement, often through a cash-out refinance.

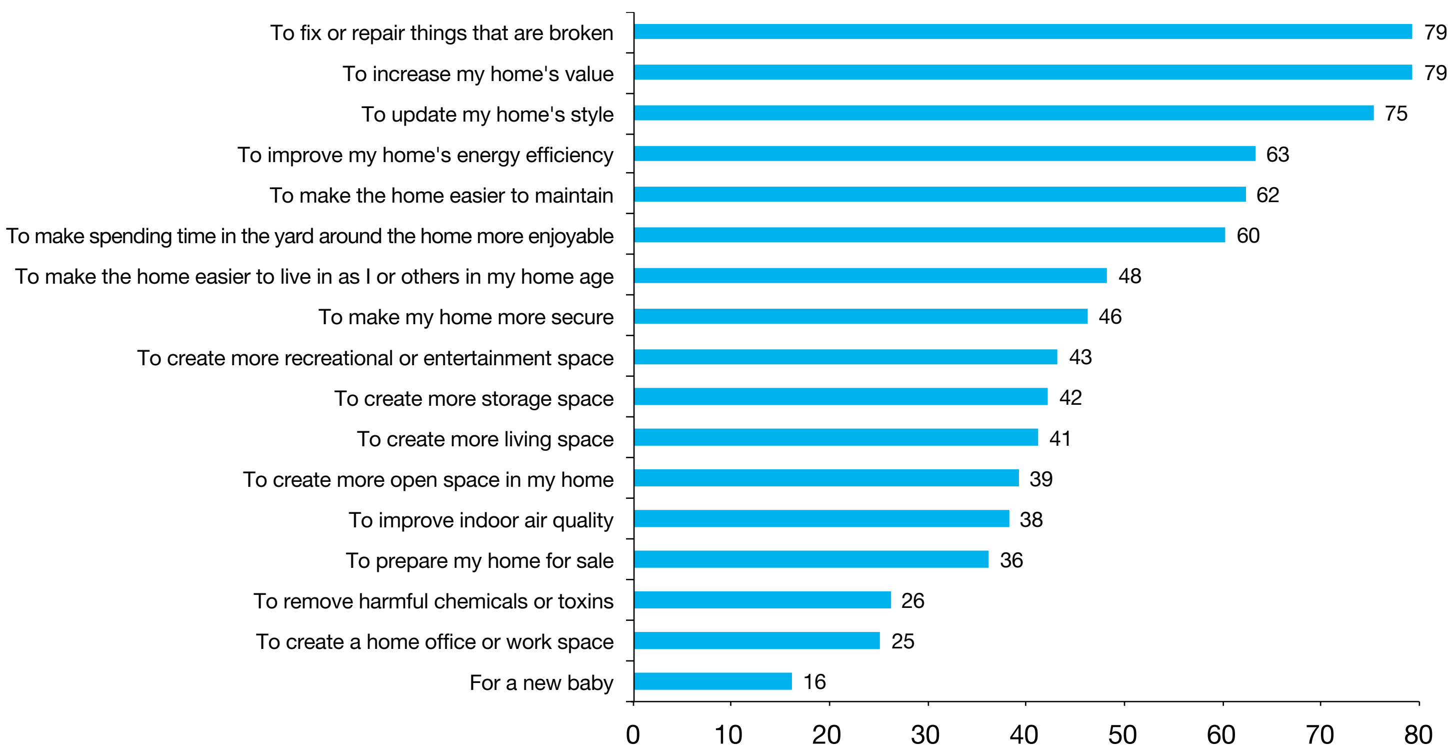
2 Joint Center for Housing Studies of Harvard University. 2015. *Emerging Trends in the Remodeling Market: Improving America's Housing 2015*. Cambridge, MA.

Prepping for a home improvement comeback

The 2015 American Communities Survey from the Demand Institute asked households about their plans for home improvement projects over the next 3 years. According to the survey, 40 percent of all households and 55 percent of owner-households said they were either very likely or somewhat likely to undergo a home improvement project in the next three years. Of those planning to undertake a project, to fix or repair things that are broken and increasing one's home value were the most common reasons (Exhibit 2).

EXHIBIT 2

Reasons for taking on a home improvement project

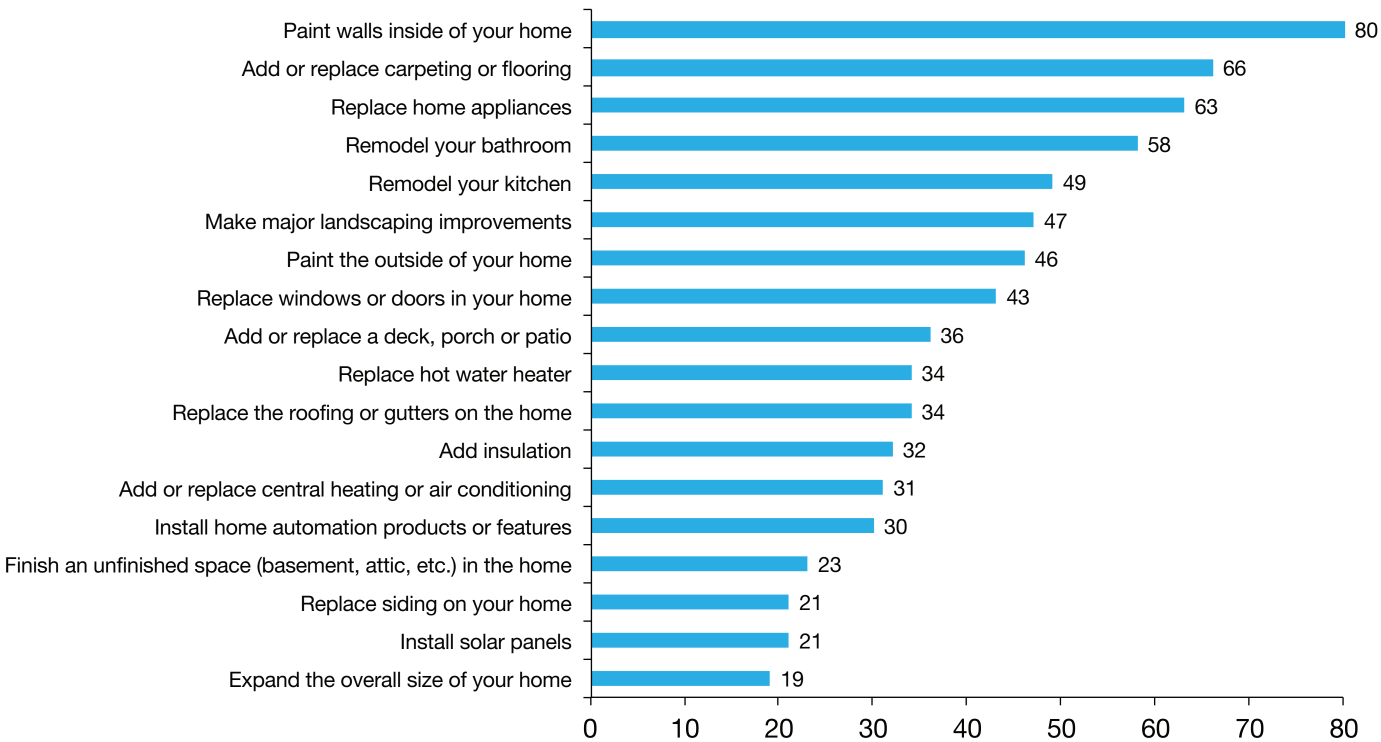


Source: The Demand Institute American Communities Survey (2015). Respondents could choose multiple reasons.

What types of projects are most popular? Exhibit 3 shows the types of projects households planning a remodeling project planned to take on. Painting interior walls was by far the most popular project, with 80 percent of respondents. Much less popular were major projects such as finishing an unfinished basement, replacing siding, or expanding the overall size of the home.

EXHIBIT 3

Top planned projects



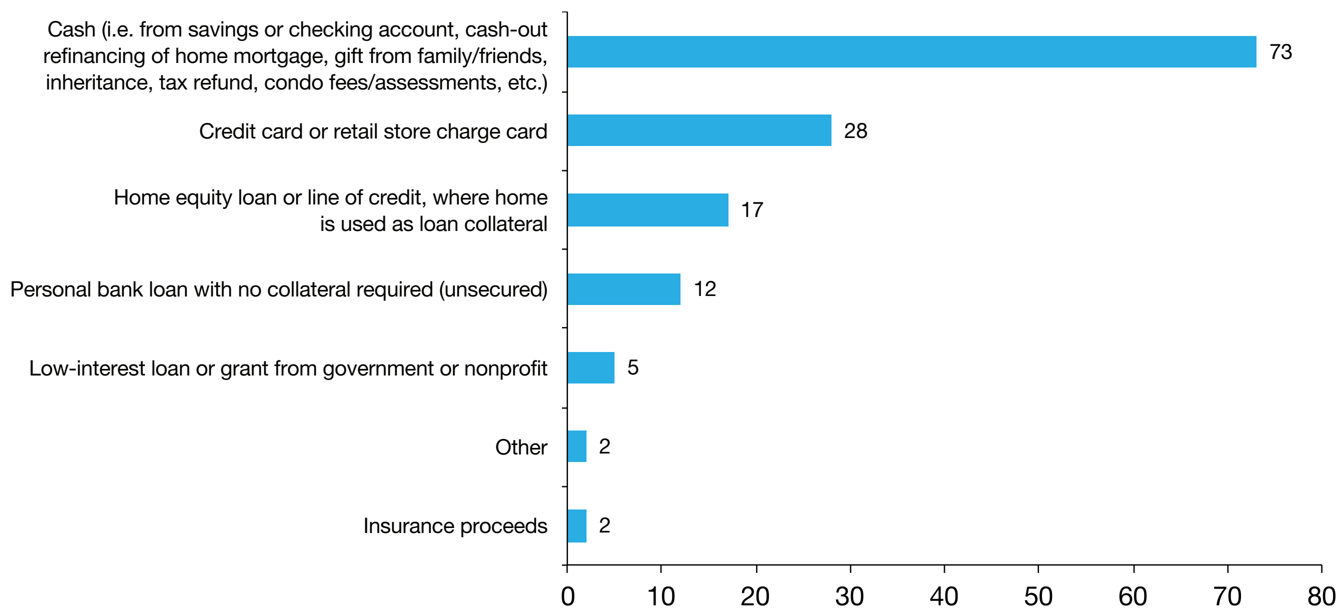
Source: The Demand Institute American Communities Survey (2015). Respondents could choose multiple reasons.

How is home improvement lending financed?

Most homeowners finance home improvement spending through cash, credit cards, or other unsecured credit. According to the 2015 American Communities Survey from the Demand Institute, of those who planned a home improvement project, 73 percent said cash would be a source of funds. Only 17 percent indicated a home equity loan or home equity line of credit would be a source of funds, with an additional 12 percent expecting to use a personal bank loan (Exhibit 4).

EXHIBIT 4

What sources of financing are expected to be used for home improvement projects?



Source: The Demand Institute American Communities Survey (2015). Respondents could choose multiple reasons.

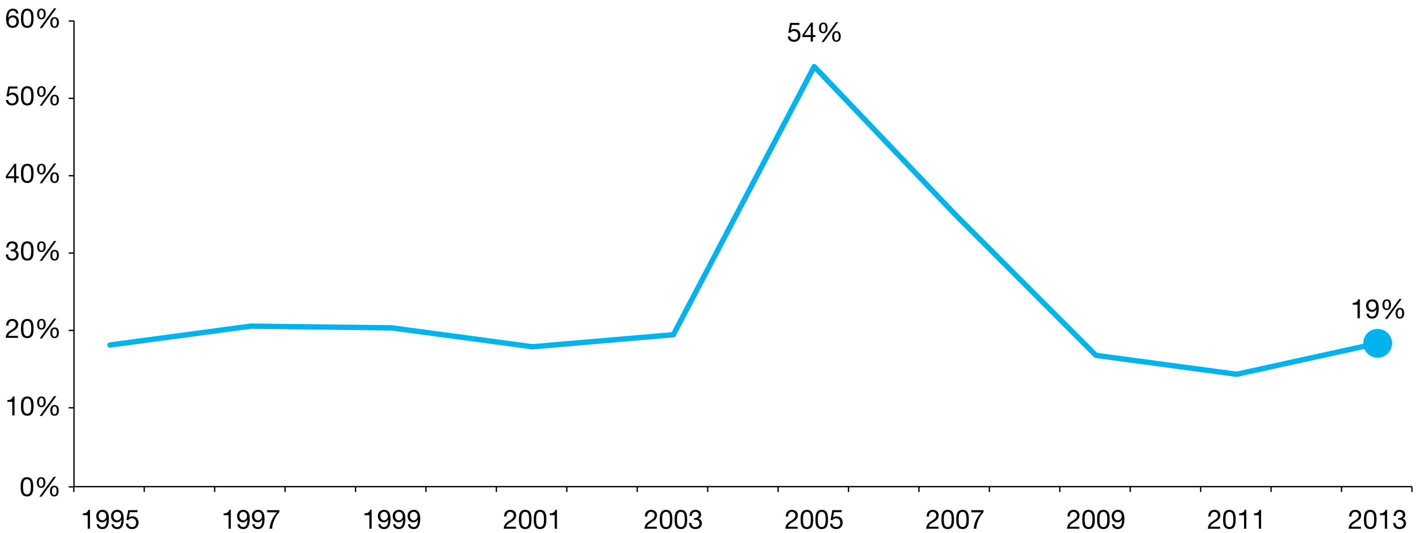
These expectations are in line with previous activity. Historically, around 20 percent of home improvement spending is financed through home loans[3] (both those secured with and without a lien against the property). The exception to this was the period from 2005 to 2007, when over 50 percent

3 In order to estimate the ratio of home improvement spending to lending displayed in exhibit 5, we took total homeowner expenditures in 2013 dollars from web-table W1 from the JCHS report, inflated by the consumer price index into current dollars. We then divided total home improvement lending in the HMDA data by total homeowner expenditures.

of home improvement spending was financed with home loans; excluding those years, the ratio has been remarkably stable (Exhibit 5).

EXHIBIT 5

Ratio of home improvement loans to home improvement spending



Total home improvement lending divided by total home improvement spending by owner-households
Sources: JCHS, BLS, HMDA

Where do home improvement loans come from?

What do we know about home improvement loans? We analyzed data from the Home Mortgage Disclosure Act (HMDA) and Freddie Mac internal data.

Lenders who report their activity under HMDA are required to identify the loan purpose, including whether or not the loan was for home improvement. Per HMDA a home improvement loan is a) any dwelling-secured loan to be used, at least in part, for repairing, rehabilitating, remodeling, or improving a dwelling (or the real property on which the dwelling in located) or (b) any loan not secured by a lien on a dwelling to be used, at least in part, for one or more of those purposes that is classified as a home improvement loan by the institution.

Most common, in terms of number of loans, are loans that fall under (b) of the above definition and are not secured with a lien. According to the 2014 HMDA data, 41 percent (by loan count) of all home improvement loans were not secured with a lien. These loans tend to be small in size, with a median loan amount of just $8,000, and thus represent only 6 percent of all home improvement lending by loan dollar amount.

The second most common are loans secured with a first lien. These loans represent about 38 percent of all home improvement lending by loan count, and 83 percent of home improvement lending by dollar amount. The median loan size for these loans was $110,000 in 2014.

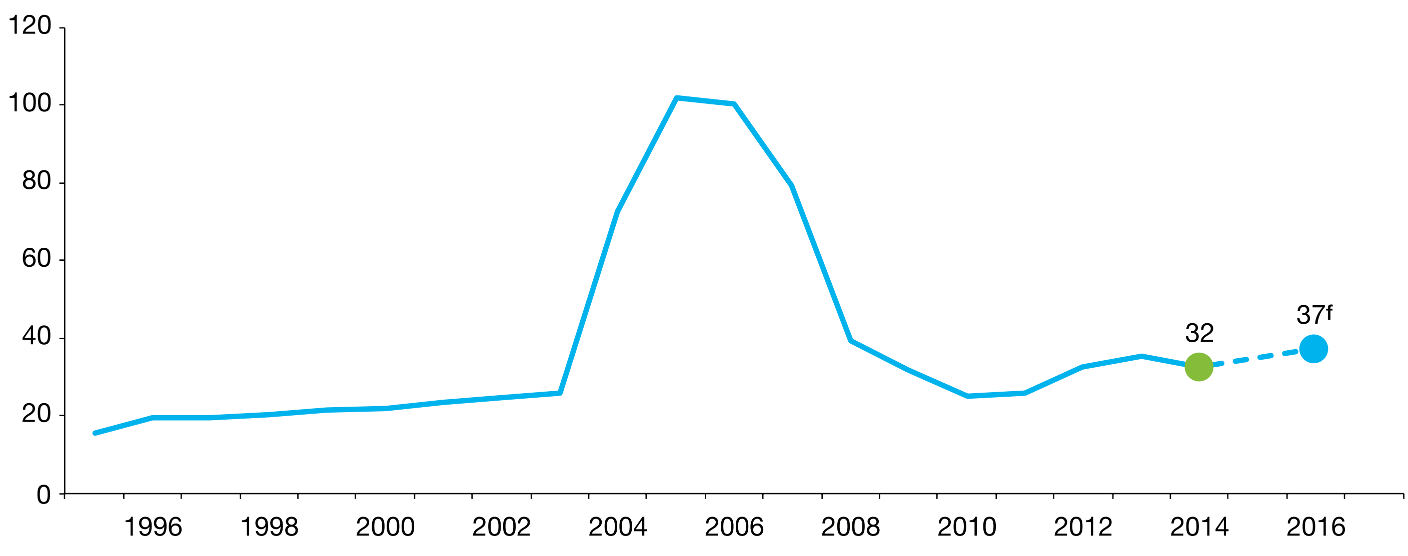
Finally, there are home improvement loans secured with a junior lien. These represent 20 percent of all home improvement loans by count and just 11 percent by dollar amount. The median loan size for home improvement loans secured with a junior line was $29,000 in 2014. Many of these loans would be home equity lines of credit.

The prospects for future home improvement lending

According to Harvard's JCHS LIRA index, which makes a short-term home improvement spending forecast, total home improvement spending will increase 15.5 percent from 2014 through the third quarter of 2016 (the last date forecasted by LIRA). If home improvement lending remains a constant share of total home improvement spending, this would imply that total home improvement lending in 2016 would increase about $5 billion to about $37 billion in 2016 (Exhibit 6).

EXHIBIT 6

Home improvement lending ($ Billions)



Source: HMDA

Home improvement lending could increase by even more than the $5 billion. As house prices continue to rise, millions more households will return to positive equity. This will give them the option to use their home equity to take a cash-out refinance or home equity loan to finance major repairs and renovations that may have been delayed due to the housing crisis. As we have documented in our cash-out refinance statistics, cash-out activity has been on the upswing in recent years and if mortgage interest rates remain low, will likely trend higher as house prices continue to rise.

Home improvement spending is an important expenditure that helps keep the U.S. housing stock up-to-date and adequate for the needs of a changing population. Many home improvement and maintenance expenditures are small and paid for out-of-pocket, but about 20 percent of the spending is financed through home loans. Large projects tend to be financed through cash-out refinances or home equity loans. With many millions of homeowners "underwater", this source of credit has been limited, but as house prices rise, home improvement lending should rise in tandem. Given strong house price appreciation this year, we expect home improvement lending to increase by at least $5 billion in 2016 relative to 2014.

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