# Residential Construction Business Conditions 2021

The building materials and construction industry’s most trusted source for market information and insights

PRINCIPIA
BRIDGING INSIGHT INTO ACTION

# Residential Construction Business Conditions

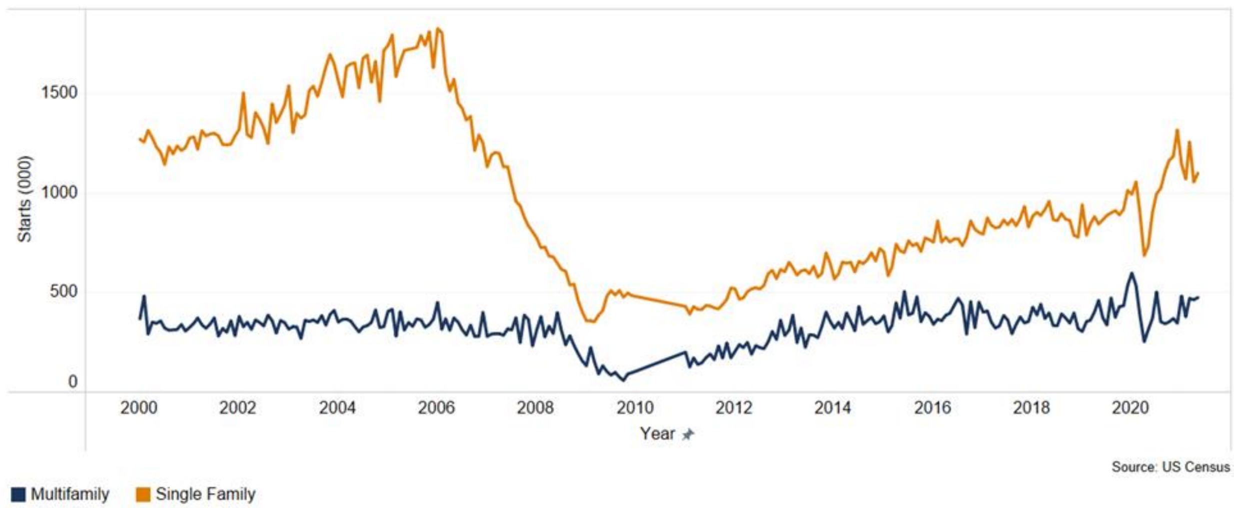
Residential construction has experienced two years of unprecedented dynamics related to COVID-19. Whereas previous construction cycles have been driven largely by economic cycles and policies, (e.g., mortgage rates, lending policies, economic activity), the past two years were dramatically impacted by an exogenous force of nature. Overall, residential construction (new construction and repair and remodel (R&R)), dropped precipitously for one quarter in 2020 from the initial pandemic impact to full recovery by year end, followed by a surge in activity in 2021.

## Demand for Residential Construction in Single Family and Multifamily, 2000–2020

New construction saw a step-change coming out of COVID-19 in new single family construction and has been running comfortably above a one million start annualized pace since August 2020, as shown in Figure 1. Multifamily has been more volatile but has returned to pre-COVID-19 levels.

All signs point to a positive outlook moving forward, most importantly two observations: (1) evidence of a significant undersupply of housing, and (2) factors constraining supply in recent years have been eased. More people are choosing to live further from major city centers, where prices are lower and zoning restrictions less onerous. In addition, there are signs the labor shortage is easing somewhat—employment in residential building construction has returned to levels from the mid-2000s.

### Figure 1: Single Family and Multifamily Starts, 2000–2020

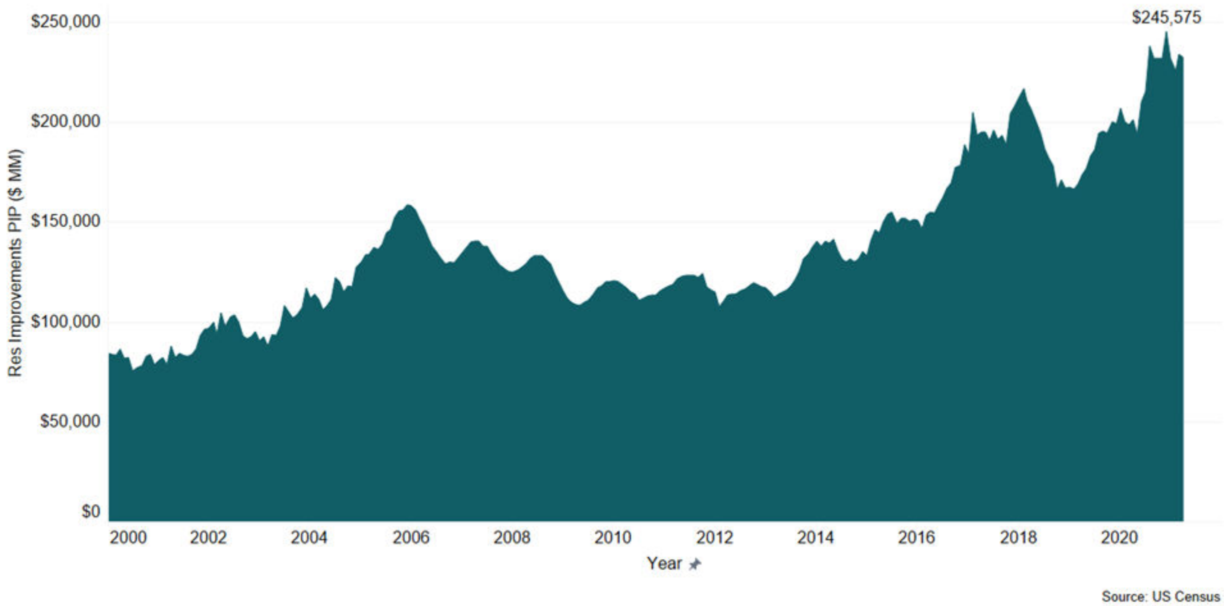




Copyright © July 2021

Spending on remodeling boomed during COVID-19 but is now showing signs of stabilization and potentially a slight reversion to mean. Put-in-Place (PIP) spending as shown in Figure 2, is heavily influenced by pricing which has been volatile, so some dampening needs to be considered with this historical construction measure.

### Figure 2: Residential Improvements Put-in-Place (PIP) Spending, 2000–2020




## Developments and Challenges in 2021

Entering 2021, the U.S. residential construction industry was faced with several broader economic undercurrents impacting housing demand as well as specific industry challenges.

### Macroeconomic Factors Influencing Homebuying Market

When the pandemic hit the U.S. in the first quarter of 2020, the economy stalled, and homebuying and selling halted. People spent more time at home, shielding themselves from the uncertainties of the coronavirus, and by the time the real estate market came alive again, people were ready to buy.

This increase in demand for homes caused listing prices to climb, and that trend has continued through the first half of 2021, due to the pandemic-fueled desires of people wanting a new home coupled with low interest rates. Mortgage rates are expected to increase the second half of 2021 as part of the hedge against inflation.

The pandemic brought about the lowest 30-year fixed-rate mortgage average in U.S. history. It dropped to 2.65% in early January 2021, down from 3.64% a year earlier. Interest rates will continue to rise but remain low through 2021 and possibly 2022. However, any significant slowdown in mortgage applications or housing sales is likely to result in interest rate reductions.


Copyright © July 2021

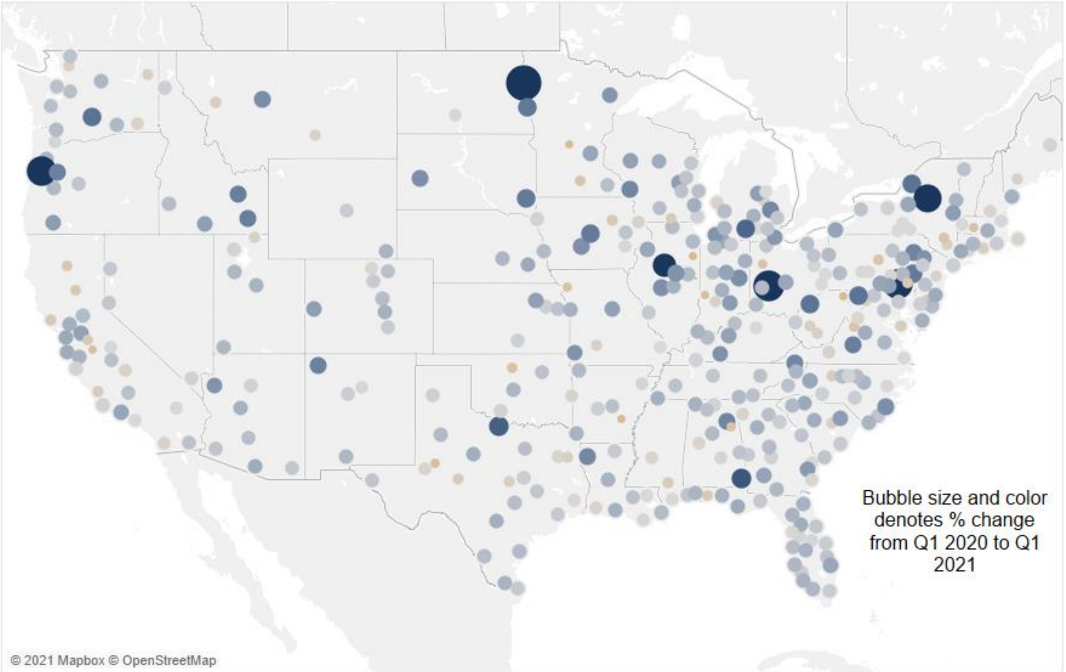
## Housing Demand Surge Amid Shift from Urban to Suburban and Rural Markets

Residential property prices rose at an annual rate of 12% in February—the fastest pace since 2006—buoyed by rising incomes, low interest rates, and a low decade-long entry into the housing market by millennials. Millennials initially moved to urban downtowns in large waves during the early years of their careers, leading to the urban renaissance of the 2010s and prompting many companies to leave suburban office parks for office buildings in central business districts. However, as millennials have matured and begun looking for affordable housing to accommodate growing families, many millennials are finding downtowns unaffordable and have been moving to the suburbs. The pandemic accelerated the shift over this past year as many millennials who had put off buying homes finally fled to the suburbs in 2020. Now, people of all ages across the country have shifted to more suburban living.

A clear preference for larger but affordable suburban homes over more expensive city environs seems to be emerging. While initially a response to the health crisis and desire for added safety, it seems that this trend is part of a larger, longer term shift in homeowner behavior. As many businesses head back to their offices, workers continue to weigh the risks of being in densely populated areas. Further, spending extra time at home and wanting more indoor and outdoor space is certainly sparking some interest among homebuyers.

A shift from city to suburban and rural has emerged as the pandemic caused homeowners to reevaluate where and how to live. The growth rate in home construction is stronger in lower-cost and lower-density markets. As shown in Figure 3, some of the largest growth CBSAs from first quarter 2020 to first quarter 2021 for single family new construction were in places like Grand Forks, ND, Springfield, OH, Utica NY, and Corvallis, OR.

### Figure 3: Percent Difference in Number of Single Family Permits, Q1 2020 to Q1 2021




Source: US Census

## Supply Shortage of New Homes and Lack of Affordable Homes

Headed into the pandemic, the housing market has been undersupplied. In fact, according to National Association of Realtors (NAR), the U.S. has been about 6.5 million homes short since 2000 and going into 2021 was facing a two-month supply of homes that should look more like a six-month supply. The magnitude of this shortage where 20 times fewer homes have been built in the past decade compared to any decade going back over 50 years is that there are simply not enough homes for millennials who represent the largest potential homeowner age group. Coming into the 2020 recession, a supply shortage of 2.5 million units existed, according to Freddie Mac.

The active listing count for January 2021 was 599,632, dropping to 496,701 in March 2021. As of June 2021, this housing inventory measure has increased to 548,864 and is likely to increase although most home sellers will turn around and buy another home. An unbalanced market where low home inventory is available and multiple buyers exist for every property up for sale is likely to remain through 2021.

While demand for homeownership spiked in 2020, and is projected to continue to grow as millennials, many of whom rent currently, form households and buy homes. However, homeownership becomes less attainable when the cost of acquiring a home increases to the point at which a household is cost-burdened (30% or more of household income spent on housing). Today, nearly a third of U.S. households are considered cost-burdened.

New homes, typically more expensive than existing homes, became less affordable in 2020 with rising building materials, labor, and transportation costs. More expensive new homes, a low supply of existing homes for sale, and the resulting staggering sales prices across the U.S. pushed more households further away from the prospect of home ownership. Finding more affordable housing drove buyers in 2020 and 2021 to outlying suburbs and exurbs where land costs are lower. However, the homebuilding industry needs supply chain constraints to ease and increase the pace of new construction to keep homeownership relatively affordable.

PRINCIPIA BRIDGING INSIGHT INTO ACTION



Copyright © July 2021

## Continued Rise in Existing Home Values and Buyer Bidding Wars

The median home list price in the U.S. was $300,000 in January 2021, climbing to $350,300 as of June 2021, as shown in Figure 4. Low interest rates and low home inventory will combine to define 2021, a set of events that will drive home prices even higher. These higher prices will not slow down buyers who will pay a premium to win a bidding war where multiple offer scenarios will pit homebuyers against as many as 10 or more competing offers. Low inventory will mean sellers should sell their home quickly and for a high price. Home prices are high across the country, so prospective buyers are unable to find a better deal by moving out of state.

### Figure 4: Median Sales Price vs. Available Months' Supply, Dec. 2016 to June 2021


Over the next couple of years, existing home prices are expected to continue to rise, but at a much slower pace. Bidding wars will start to taper off, and staggering offers over asking price will eventually come down. However, this does not mean prices will return to their pre-pandemic levels. List prices are expected to continue rising to meet sale prices, but the annual increases will be more limited.

Record-low interest rates have allowed buyers to purchase more expensive homes while keeping monthly payments within their budgets. As interest rates rise, buyers will find greater difficulty to afford higher home prices. Further, an increase in inventory would give buyers more choices and tamp down the current bidding wars.



Copyright © July 2021

## Supply Chain Constraints Impacting Homebuilding

Residential construction is faced with many of the same problems it has faced in years past: a skilled labor deficit, increased lumber prices, supply-chain disruptions, restrictive zoning laws, and costly permits. Builder headwinds persist with many homebuilders currently at capacity or dealing with these issues. These problems make it extremely difficult for homebuilders to generate a profit on entry-level homes, which in part reflects the shortage of affordable homes.

Over 1.5 million workers consisting of carpenters and specialty trades either lost their jobs or quit and left the industry during The Great Recession. A deficit remains even though roughly one million workers were added back over the last decade.

Rising prices and shortages for building materials starting in 2020 have continued through the first half of 2021 and will remain tight through the rest of the year. Notably lumber prices have increased exponentially as sawmill capacity was first reduced due to COVID-19 and then still unable to meet demand. At the same time, homeowners were spending most of their time at home, and do-it-yourself (DIY) projects skyrocketed, spiking demand for building materials. The demand versus supply constraint for lumber has lessened and prices have fallen in June 2021 although still significantly higher than pre-pandemic levels.

Stringent zoning laws make it costly to build and overall restrict housing development. This has created challenges to build in areas where there is a major housing shortage such as California. Some of these laws are supported by residents who do not want multifamily zoning in their neighborhoods and vote against multifamily construction, leading to driving up land cost.

## Sustained Pace in Remodeling Activity

The remodeling market quickly recovered during the pandemic as Shelter-In-Place (SIP) and Stay-At-Home (SAH) restrictions grounded Americans in their own homes. Instead of travel and entertainment, homeowners spent on repairs and improvements to owner-occupied and rental properties resulting in an overall growth of 3-4% for 2020 which was higher than anticipated for the year pre-pandemic.

DIY projects became the accelerant for this remodeling growth due to homeowners spending more time at home and not wanting professional contractors in their homes. Some exterior product categories like outdoor living grew much faster than the average project, owing to homeowners wanting to be outside in their own surroundings. As the year progressed and fully into 2021, professional contractors were hired, particularly for exterior projects such as roofing, siding, windows, and decking. Simple DIY remodeling projects such as painting helped to support growth for architectural coatings. While interior projects were slower to resume with professional installers, the pace has picked up briskly in 2021 for kitchen and bathroom remodeling, flooring installations, and HVAC replacement, among others.

PRINCIPIA
BRIDGING INSIGHT INTO ACTION
Copyright © July 2021

## Impact on Building Materials Industry

The building materials industry has benefited from the overall housing demand in both new construction and R&R activities. The counter to this increased demand is the impact of short supply. Plant closings and a reduced workforce during the height of the pandemic limited the manufacturing and shipping of building materials. However, the booming residential construction market resulted in supply shortages and escalating prices.

Availability of nearly every building products category, from lumber, steel and gypsum to windows and interior finishes like countertops and faucets, has been affected starting last year and continuing through the first half of 2021. Surging lumber prices alone have increased the price of an average new single-family home by over $35,000 as of second quarter 2021 although sawmill capacity has caught up and prices have begun to decline. Substitution within product categories is occurring due to availability or price, e.g., away from wood toward non-wood products in decking, railing, trim, and sheathing, or away from fiberglass to cellulose in attic insulation, or fiberglass toward steel in entry doors. Another observation is that vinyl siding and windows have seen significant price increase compared to other materials.

Starting late second half of 2021 into 2022, these supply chain dynamics will start to resolve, residential construction demand will somewhat rebalance, and the recent supply and price pressures are expected to ease to pre-pandemic levels. Meanwhile, many building product manufacturers have placed their customers on allocation for the rest of the year.

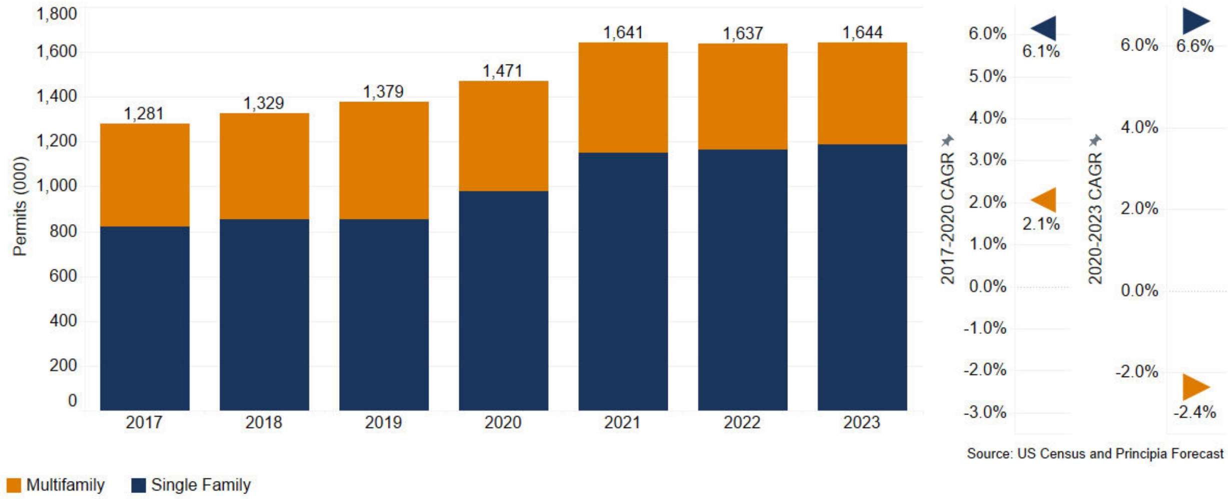
PRINCIPIA BRIDGING INSIGHT INTO ACTION

Copyright © July 2021

## Demand for Residential Construction in Single Family and Multifamily

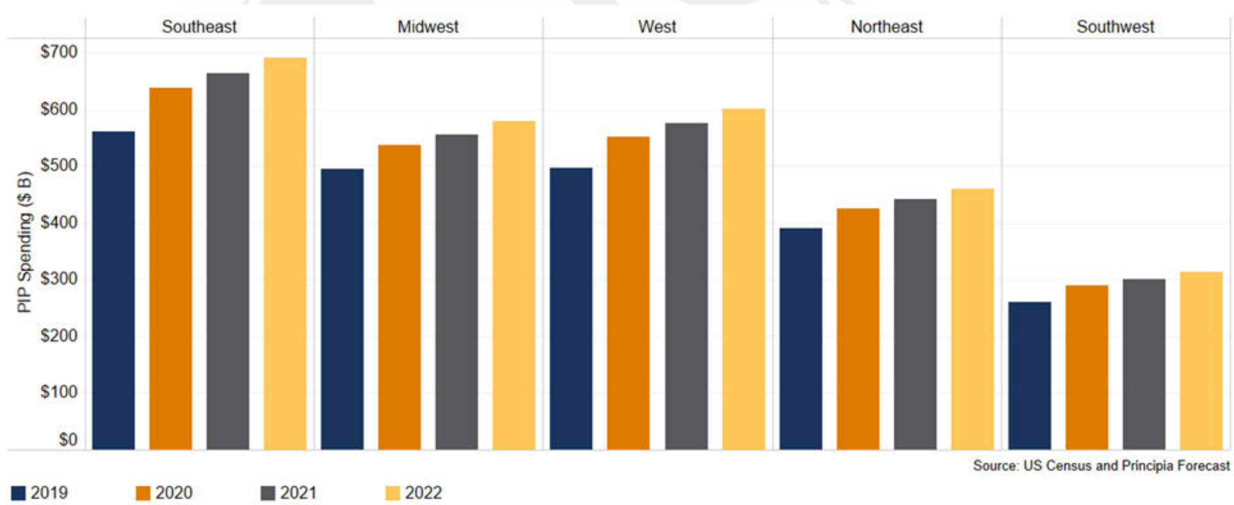
As shown in Figure 5, current single family permits are increasing beyond industry expectations but have not reached historical levels dating back prior to The Great Recession. Multifamily new construction has remained steady. Homeowners are staying in place and spending record high money on remodeling their homes or buying existing homes and renovating.

### Figure 5: Principia New Construction Housing Forecast, 2017–2023




New home and renovation demand has been shifting to lower cost areas such as the Southeast and Midwest as people are priced out of high cost of living areas on the east and west coasts of the United States, as shown in Figure 6.

### Figure 6: Residential Improvements Put-in-Place Spending by Region, 2019–2022




## For More Information

If you would like more details or some specific guidance regarding your business and how we can assist, please contact us at 610-363-7815 or info@principiaconsulting.com.


Copyright © July 2021

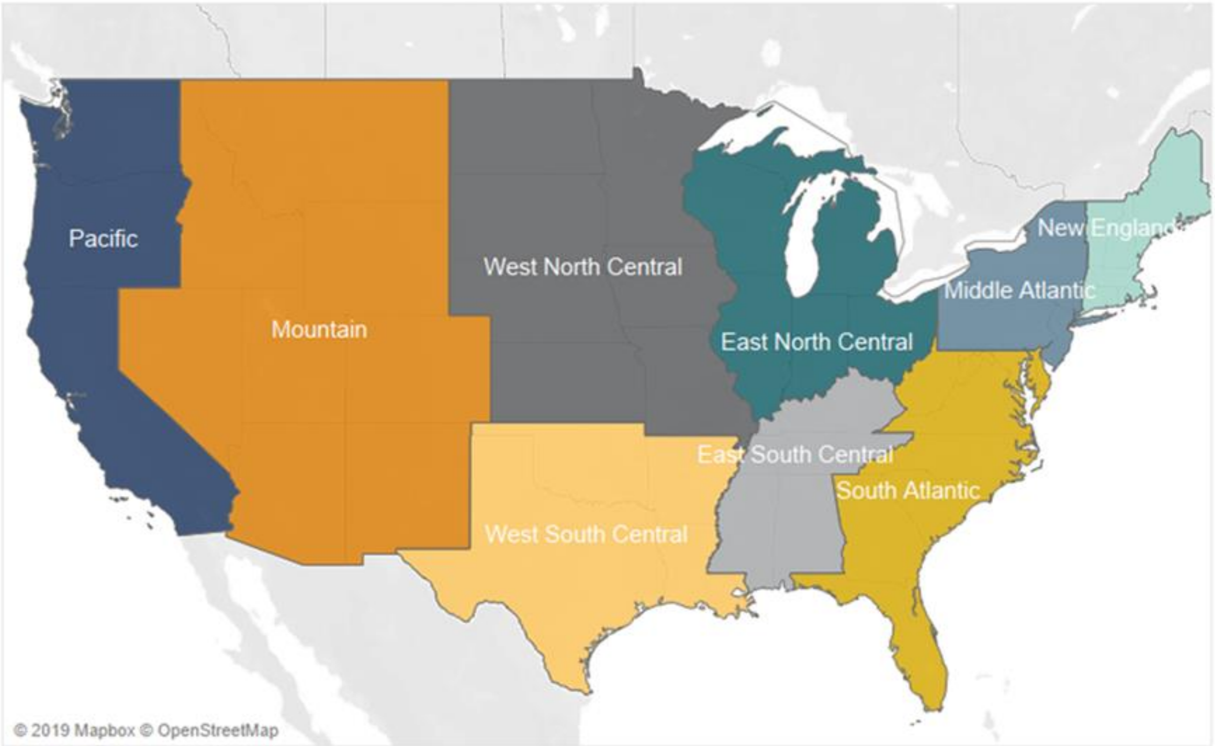
# Geography

## Geographic Scope

In Principia's research, demand and supply are broken out according to the following U.S. Census Bureau regions and divisions. The South region is proportionately larger than other regions, so Principia further segments the South region by Census division into Southeast and Southwest regions.

### Figure 7: Geographic Regions and Divisions

| Regions | Divisions | States/Provinces |
|---|---|---|
| **Northeast** | New England | CT, MA, ME, NH, RI, VT |
| | Middle Atlantic | NJ, NY, PA |
| **Midwest** | East North Central | WI, MI, IL, IN, OH |
| | West North Central | ND, SD, NE, KS, MN, IA, MO |
| **Southeast** | South Atlantic | DE, MD, DC, VA, WV, NC, SC, GA, FL |
| | East South Central | TN, MS, AL, KY |
| **Southwest** | West South Central | OK, AR, TX, LA |
| **West** | Mountain | ID, WY, NV, UT, CO, AZ, NM, MT |
| | Pacific | CA, OR, WA, AK, HI |





Copyright © July 2021

Principia is a leading research and consulting firm focused exclusively on the building materials and construction industry.

For over 25 years, we have helped our clients grow faster and more profitably by providing high quality information, analytics, and insights.



PRINCIPIA
BRIDGING INSIGHT INTO ACTION

101 Lindenwood Drive, Suite 225, Malvern, PA 19355

P: 610.363.7815 | info@principiaconsulting.com

principiaconsulting.com