Residential Business Conditions

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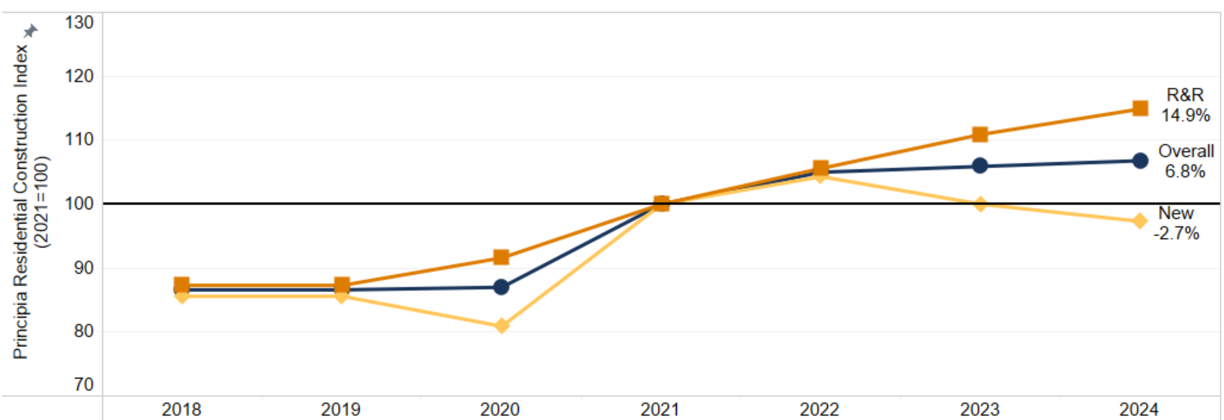
Residential Business Conditions 2022

The Principia Residential Construction Index (PRCI) forecasts overall spend will grow 7% from 2021–2024, as growth in repair and remodeling (R&R) offsets the decline in new construction. PRCI represents the composite growth in demand (net manufacturer revenue) of 14 residential building products tracked by Principia. The index serves as a proxy for residential construction activity based on broad coverage of building products included. Demand in R&R in 2024 will be 15% above 2021 levels and 3% down for new construction, as shown in Figure 1.

> **Overall residential construction spend will grow 7% from 2021–2024, as growth in R&R offsets decline in new construction.**
>
> *—Principia Residential Construction Index*

For this year both new construction and R&R are growing at approximately a 5% rate. Forecast demand will diverge from there, with R&R growing at a CAGR of 4.3% through 2024 while new construction declines by 3.4% per year. Overall demand will grow at a 1% CAGR from 2022–2024.

Figure 1: Principia Residential Construction Index (PRCI)[1]



2018-2021 data includes material price changes, 2021-2024 forecast holds material prices constant *Source: Principia BuilderSeries*

Principia projects housing starts will begin a gradual descent next year; and existing home sales indications may trend the same way. In May 2022, the Pending Home Sales Index (PHSI) from Realtor.com fell for the sixth consecutive month and reported the first year-over-year increase in overall housing supply since June 2019.

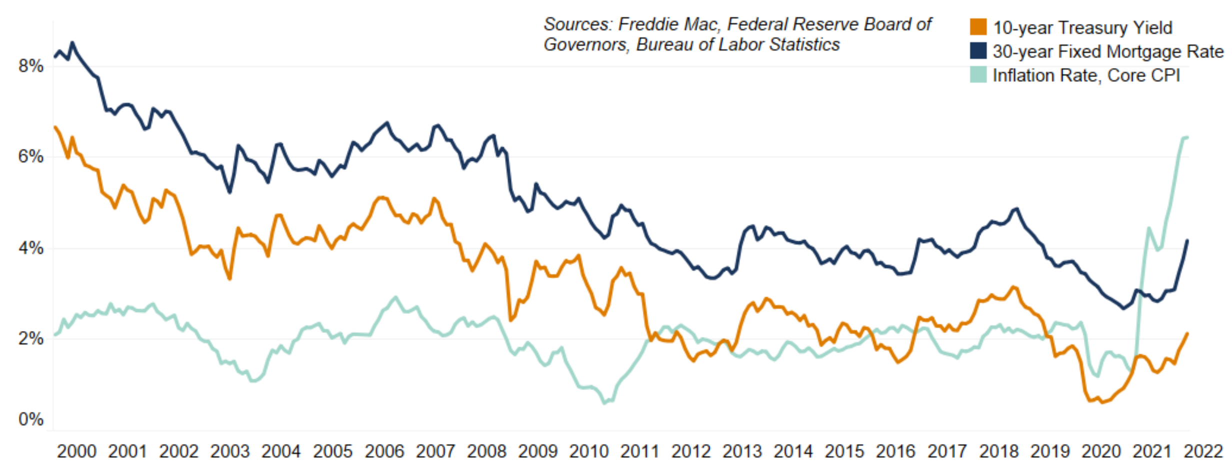
Higher mortgage rates and skyrocketing median prices for existing homes may price many homeowners out of the market, which will likely force home prices down as the U.S. endures its worst inflation in 40 years. Redfin reported that in May 2022, one in five U.S. home sellers lowered their asking price—the highest number since October 2019.

[1] Note: Index based on 14 residential building products: cabinets, countertops, decking, doors, exterior trim, flooring, insulation, interior trim, lumber, railing, roofing, siding, wallboard, windows. PCRI reports demand segmented by new construction vs. R&R along with an overall total. Weighting varies by year, but on average, R&R accounts for 56% of annual spending.

Since 2000, both the 30-year fixed mortgage rates and 10-year treasury yield have charted similar courses. In the case of the former, they've been cut in half over that time, while the treasury yield is less than a third of what it was at the turn of the millennium. Beginning around 2011, the inflation rate was on pace with the 10-year treasury yield, and occasionally surpassed it leading up to the most recent recession. But, at the halfway point of 2022, inflation has skyrocketed, and for the first time since before 2000, has soared past both the yield and 30-year fixed mortgage rate, as shown in Figure 2.

Higher mortgage rates and skyrocketing median prices for existing homes may price many homeowners out of the market.

Figure 2: Interest Rates & Inflation, 2000–2022

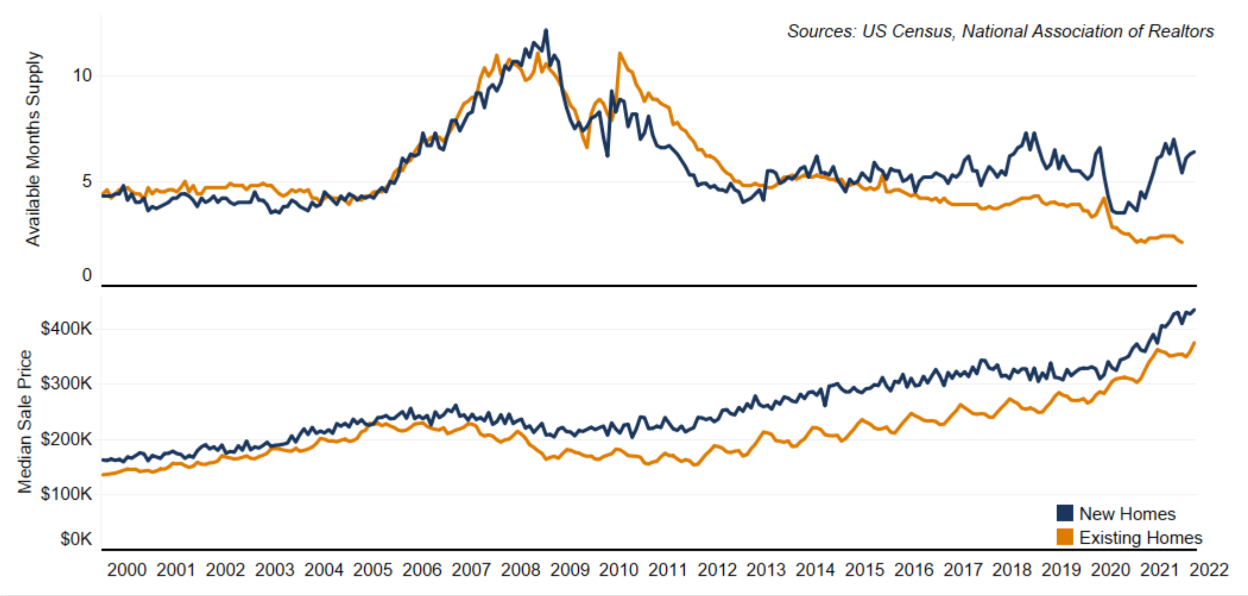


The available months supply for existing homes has never been lower, and the gap between the supply of new and existing homes has never been wider, as shown in Figure 3. The short supply of existing homes is a result of years of underbuilding. COVID-19 reshaped preferences for where we want to live.

Homebuyers flooded into major metros during the Great Recession. The opposite happened after the pandemic: homebuyers fled major metros, seeking affordable homes for purchase in outlying areas as work-from-home became acceptable and densely populated cities became risky. In these lower-density markets, low supply and high demand spurred bidding wars for existing homes and frantic activity delivering new homes.

Millions of buyers competing for a limited number of homes for sale drove existing home prices to record highs in 2021, as shown in Figure 3. At the same time, homebuilders accelerated deliveries of new homes, struggling through product and labor constraints. The median sales price of new and existing homes skyrocketed, pushing homeownership beyond the reach of an increasing number of Americans.

Figure 3: New and Existing Homes Inventory and Pricing, 2000–2022



New Construction

As a potential recession looms, all eyes are on the housing market. The Great Recession of 2007, lasting 18 months, was driven by the subprime mortgage crisis. It took 16 years for the housing market to return to pre-burst levels, and it's been mostly smooth sailing since.

The world is still suffering consequences from 2020's COVID-19 economic dip and now we prepare for the possibility of an unwelcome recession. One of the biggest housing hiccups to linger from the COVID-19 impact is the weakened supply chain. Principia has seen it in all facets of domestic supply to residential construction including imports as the war in Ukraine disrupts the supply of some key raw materials. China—one of the world's biggest exporters of residential building materials to the U.S.—is now forced to raise prices on certain plumbing materials and deal with tariffs that affect a variety of materials, including the import of ready to assemble (RTA) cabinets.

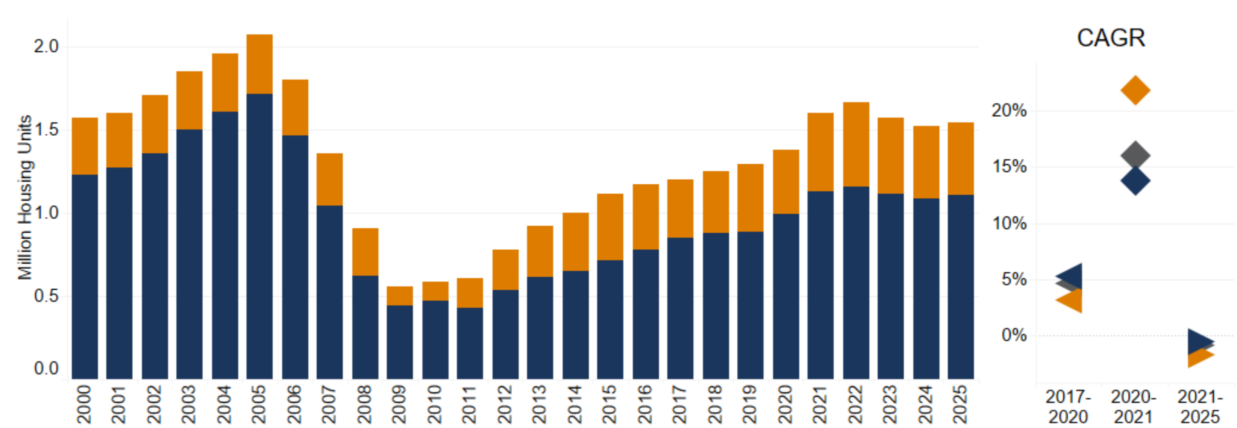
Labor shortages continue to take a toll on construction activity. In fact, a 2022 model developed by Associated Builders and Contractors reveals that the construction industry will need to attract nearly 650,000 additional workers on top of the normal pace of hiring to meet labor demands.

The combination of scarcer supplies, international adversity, and labor shortages drives extended lead times across all categories. Domestic transportation bottlenecks are impacting lead times which are longer than ever. All this volatility has forced manufacturers to devote their energy on serving existing customers and managing supply chain challenges and put new-business efforts on the backburner. There is, however, an expectation among manufacturers that the supply chain will gain strength over the next few months, particularly if ocean freight costs continue to decline and the housing market cools off. These types of supply issues will persist until at least 2023, but their severity should diminish enough to free up manufacturers to forge ahead with other business initiatives.

Growth in home starts has climbed since 2009, and in April 2022 reached highest mark in 12 years.

The good news is that, for now, cumulative annual growth rate (CAGR) of both single family and multifamily home starts has been on the rise since 2009, as shown in Figure 4, and, in April 2022, hit its highest mark in 12 years.

Figure 4: Housing Starts, 2000–2025

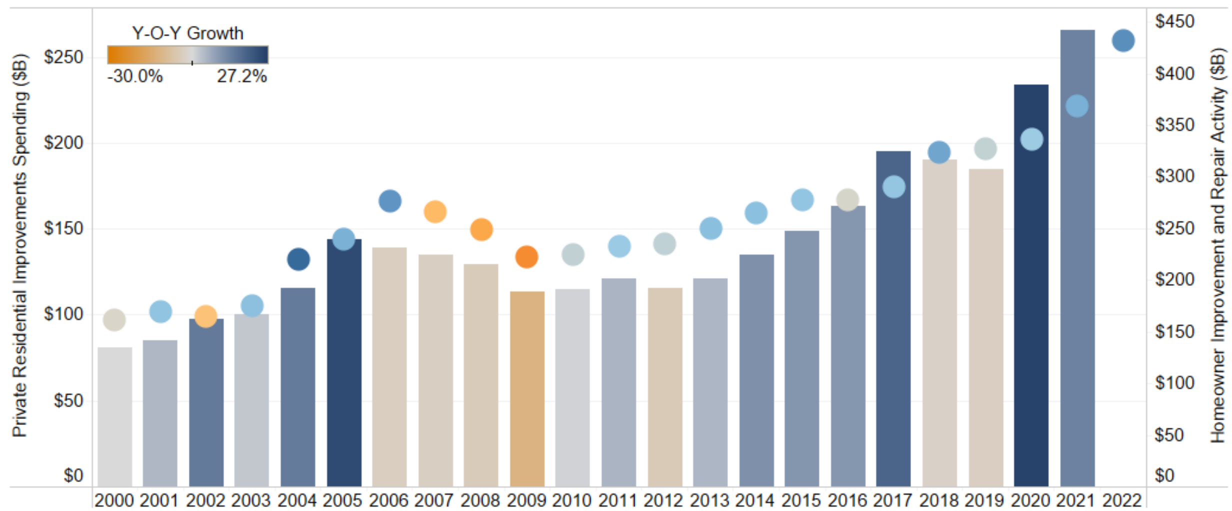


Source: US Census Bureau, Principia Forecast

Repair and Remodeling

Remodeling is projected to fuel building products demand growth through 2024 as new housing starts fall. Remodeling and home improvement spending surged in 2020 as Americans invested in their homes at record levels and remained strong in 2021. According to U.S. Census data, expenditures for residential improvements increased 14% in 2021 and are trending higher in 2022. Residential improvement and repair spending is projected to grow 17% between 2021 and 2022, as shown in Figure 5.

Figure 5: Repair and Remodeling Spending, 2000–2022



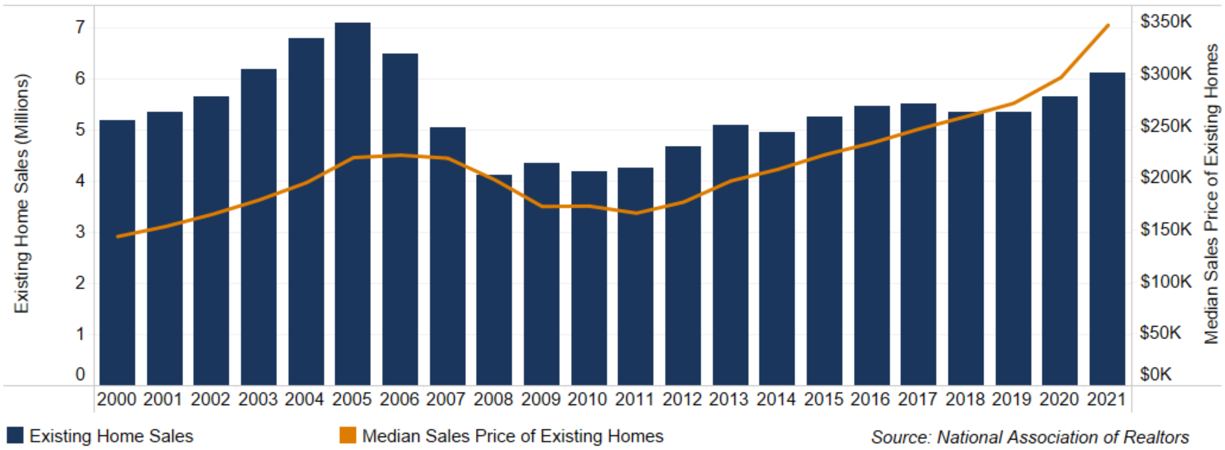
Bars reflect Private Residential Improvements Spending (Census Put In Place Spending)
Bubbles represent Homeowner Improvement & Repair Activity (Census American Housing Survey), forecast from Harvard LIRA

Existing home sales are a major driver of remodeling activity and have been growing over the last several years. Often sellers touch up their homes in anticipation of the sale and buyers upgrade the home on completion of the sale. In addition, the average duration of homeownership increased to 13 years. This extended time in home encourages people to invest in upgrading their living environment.

Existing home sales are a major driver of remodeling activity and have grown over past few years.

With only a few minor blips, the R&R market has rapidly grown since 2013 and, in particular, since 2019. In fact, private residential improvements spending has increased from around $185 billion to near approximately $265 billion in 2021. With options for travel limited, many consumers were able to save money during the pandemic and benefit from home-price escalation, too. Having extra money and more time on their hands allowed many homeowners to begin DIY projects and consider more involved R&R initiatives. One of the outcomes of these improvements has been a concomitant increase in home prices, as shown in Figure 6.

Figure 6: Existing Home Sales and Median Sales Price 2000–2021



Summary

New home construction is often the focal point of the outlook for the construction industry. Principia's historical analysis shows that the growth of each product category is somewhat determined by the balance of new construction and R&R demand.

In times of booming new home construction, categories like lumber and insulation fare particularly well while demand for products like flooring, cabinets & countertops, and outdoor living products, e.g., decking, is more consistent throughout construction cycles. Our PRCI outlook for building products demand in the near and mid-term is shown in Figure 7.

Figure 7: PRCI Short and Mid-Term Outlook for Building Products Demand

Change from	New	Repair and Remodeling	Overall
2021 to 2022	+4%	+6%	+5%
2021 to 2024	-3%	+15%	+7%

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

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