

Leveraging Economies of Scale for Remodeling Work

Diversifying into 2 separate divisions could spell success for builders.

By Patrick S. Duffy

During a session at last month's International Builders' Show in Las Vegas, a presenter suggested that struggling builders could bring in some much-needed business by approaching banks to help remodel or repair foreclosed properties which had been damaged by angry borrowers. Say what? Work with the same type of enemy that's been allegedly forcing private builders into foreclosure and bankruptcy?

And yet for those builders willing to expand their horizons, taking on such work is quickly becoming a means to keep core staff busy not only during the current recession, but act as a counter-weight in future downturns. As an aggregate number, this is big business: according to the NAHB, in 2007 total remodeling expenditures were estimated to be about \$230 billion. Moreover, given the combination of an aging housing stock, millions of underwater homeowners unable to move or lose money, and demographics which increasingly favor aging in place, the future certainly suggests a robust business for room additions and upgrades.

So just how big could this opportunity be? Assuming the country successfully negotiates through the current economic downturn, the NAHB estimates that the value of remodeling jobs could approach \$400 billion by 2015, or

closing in on the estimated \$455 billion in new construction. By 2020, it's quite possible that the remodeling industry could even eclipse the value of new homes built annually. If that comes to pass, then the most successful home builders would be diversified entities with two separate divisions: one which develops new communities, and one which improves those which already exist.

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Indeed, many smaller production and custom home builders have already adopted this model to keep their companies afloat. Another recent study from the NAHB reports that 50 percent of its builder members are now taking on remodeling jobs, and once they start up these divisions, it's unlikely that they'll simply shut them down when the market improves.

Of course for those builders venturing into this arena, the economies of scale which builders have historically enjoyed with various suppliers and subcontractors will certainly put pressure on existing remodelers, whose aggregate business fell by 4% in 2007. In 2008, according to Harvard's Joint Center for Housing Studies, this decline is expected to have more than doubled to 9% and rise to 11% during the first quarter of 2009. And, since the remodeling industry grew by 40% in the last cycle, it's expected to lose about one-third to one-half of

that gain in this slump.

Despite these declines, since they're less than those impacting the home building industry – with starts off by over 65% since the start of 2006 – builders still see it as a comparatively safe business, and one in which partnering with larger remodelers makes sense. And when the market does rebound, it's expected to grow at a 4% annual clip.

That growth, in turn, will also be good for both the private economy as well as federal, state and local governments. The NAHB says that for every \$100,000 spent on residential remodeling, 1.30 jobs are created for additions and alterations and 1.25 jobs for maintenance and repairs. For public services, that same \$100,000 provides nearly \$28,500 in taxes and government revenue for additions and alterations and nearly \$27,800 for maintenance and repairs, which in many states could make a dent in serious budget gaps.

As of the most recent American Housing Survey for 2007, the total U.S. housing stock totaled over 128 million units. But with a median age at that time of 34 years and over 41 million homes close to 50 years of age or older, perhaps the idea of approaching banks to help them maximize the value of their foreclosed assets doesn't sound like such a bad idea at all.



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Fast Facts



- By 2015 total U.S. remodeling expenditures forecast to approach \$400 billion.
- \$100,000 spent on remodeling = 1.25 to 1.30 jobs are created.
- Over 41 million U.S. homes are close to 50 years of age or older.
- \$100,000 spent on remodeling = \$27,759 to \$28,479 in government revenue.