OUTLOOK FOR CANADIAN RENOVATION SPENDING: BUILT ON STURDY FOUNDATION

Highlights

• Despite some recent ups and downs, home renovation spending has surged at an annual average rate of 7% over the last decade.

• A robust housing market has played a major role in supporting renovation investment, as homebuyers upgraded their new purchases and sellers prepared their houses in attempt to command top dollar. The positive wealth affect from appreciating home prices has provided a further upward thrust. We estimate that gains in home sales and prices together have accounted for roughly half of the growth in renovation activity since 2003.

• Over the remainder of this year and in 2014, growth in renovation spending is expected to slow to about half its historical rate. In the near term, spending is likely to be bolstered by reconstruction activity following the summer floods in Calgary and Toronto. By 2015, a softer housing market and an upward trend in interest rates will likely lead to a further cool-down in housing-related investment.

• While home improvements to add quality and value to ones home were likely more popular forms of spending over the last decade, renovations to help make homes more accessible for seniors are expected to be a bigger source of renovation activity over the longer term.

Supported by the popularity of reality shows such as Property Brothers and Holmes on Homes as well as a booming housing market, Canadians have ramped up spending on home renovations and improvements. At 7% per year since 2003, spending gains in this area have outshone other components of household spending. During the 1990s, outlays for home renovations accounted for just over 25% of total residential investment. Currently, that share is almost 40%. Accordingly, the sector’s economic importance has grown significantly over the past decade.

Looking forward, a more moderate pace of renovation spending activity is anticipated. Restoration activity related to the floods in Alberta and Ontario will bolster renovation spending over the near term. This development, along with relatively stable housing demand, will likely translate into reasonably healthy spending gains in the 3-4% range this year and next. In 2015, the combined effect of higher interest rates, elevated household debt levels and a cooling in housing markets is likely to lead to a modest dip in renovation outlays. That said, the $45 billion in total renovation activity expected in that year will still be more than double its level of a decade ago.
Defining renovation spending

For the purposes of this report, we have relied on home renovations data compiled by Statistics Canada. The agency refers to renovations as work done to a house in order to improve the quality or add value to a home. More precisely, it encompasses:

- **Structural additions** to property. For example, adding rooms, pools, landscaping and decks,

- **Renovations and alterations**, which includes work done to upgrade the property to acceptable building standards and modernizing existing facilities without changing the type of occupancy, such as remodeling rooms, adding or replacing doors and windows, renovating exterior walls, upgrading insulation and adding eaves trough;

- **New installations**, which include the installation of equipment not previously in existence, for example, the installation of fixed electrical home appliances;

- **Replacement of equipment** is the installation of equipment that replaces an existing unit. For example, the replacement of a roof, carpet, heating system or air conditioning system).

Regular maintenance and repair is not included in the discussion of renovations. The level of renovation spending includes all costs associated with the work being done, including labour and taxes. Renovation activity as cited by Statistics Canada does not include those tied to the underground economy.

Strength in renovation spending tied to housing

Over the last ten years, a number of economic factors have contributed to the strength in renovation spending, including a robust labour market, strong income gains and an aging housing stock. The average home in Canada was built in the 1970 to 1980 period and was likely due for some upgrading. Still, the most important factors have been the availability and the falling costs of credit as well as a record-setting decade in the resale housing market.

Rising home sales tend to lead to renovation spending as home buyers upgrade their new purchases and sellers prepare their homes for the marketplace – a process called “staging”. CMHC estimates that households tend to spend $21,000 more in the year following the purchase of a home on renovations and furniture. That implies that home sales alone contributed almost one-third to average total renovation outlays since 2003, or roughly $13 billion dollars annually.

As gains in home sales have tapered off over the past half decade, the wealth effect associated with robust home price gains has become a more important growth driver. Increases in home valuations makes households feel wealthier and more willing to go out and spend. Studies show that for every $1 increase in wealth due to home price appreciation, households go out and spend an additional nickel – some of which ends up in renovations.

Furthermore, the more homes have appreciated in value, the more households could extract equity from their homes for the purpose of investment and spending. The growing popularity of home equity lines of credit (HELOCs), in particular, have provided households with a relatively cheap
and flexible way to finance home renovations. Increased amortization periods on mortgages and other measures that have loosened credit conditions have added fuel to the fire. The Bank of Canada estimated that 40% of HELOCs and mortgage refinancing were used for renovation and consumption purposes alone.

We estimate that home sales and price gains accounted for as much as half of the renovation activity that has occurred over the last decade – a fact that underscores the importance of conditions in housing markets to the prospects for the renovation industry.

Renovation spending…recession proof?

Counter to historical experience, the renovation sector made it through the recent economic downturn in 2008-09 relatively unscathed. In fact, it was the only major component of GDP that managed to grow in 2009. That outperformance was due in no small part to the inclusion of a temporary renovation tax credit to the federal government’s economic stimulus package. Households received a tax credit worth 10% of any renovation spending conducted during January 2009 and February 2010, up to a maximum of $10,000. Along with record low interest rates, the credit worked. It helped boost renovation spending by an estimated $3-4 billion over that period.

Since 2010, renovation spending in Canada has turned in more modest growth of around 2.5% per year. Although the underlying economic landscape has remained reasonably constructive, with jobs and incomes continuing to expand at a decent clip, other tailwinds have turned into modest headwinds. Some of the boost from the renovation tax credit may have come from newly planned spending, but most of it was likely due to families bringing future renovation spending plans forward to take advantage of cost savings associated with the tax credit. As a result, renovation activity has suffered a post-stimulus hangover since the expiration of the tax credit in late 2010.

Another recent development that has clipped the sector’s growth wings has been the cooling trend in household borrowing. Household credit is currently growing at its slowest pace since 2003. What’s more, since 2008, Canadian governments have reversed course on lending practices, reducing the amortization rate on mortgages, restricting investor activity and capping the amount households can borrow off the equity in their home, particularly through HELOCs.

While historically renovation spending may have been largely funded through borrowing, the impact from tighter credit conditions has been limited. A 2012 CMHC survey showed that almost 70% of renovation activity was paid for through savings rather than debt. Our estimate is that the changes implemented since 2008 have only shaved roughly 1.2 to 1.5 percentage points off of average annual renovation spending growth since 2008.

Households no longer “doing it themselves”?

The recent moderation in renovation spending has not been felt equally throughout the sector. Statistics Canada figures show that retail spending in building material and supply stores has stagnated since 2007. In contrast, renovation-oriented wholesalers have experienced above average growth over the past 3-4 years. Since households tend to purchase material at retail locations and builders and busi-
business owners have access to wholesalers, this trend would suggest that more and more households have been turning to contractors for work rather than doing it themselves.

### Spending has grown across the country

With all major housing markets across Canada enjoying good times since 2003, it might not come as much of a surprise that the strength in renovations spending has been relatively broadly-based. Provinces in the prairie region (Alberta, Saskatchewan and Manitoba) recorded modestly better growth performances, reflecting the relative strength of their economies and housing markets over the period. The shift to more reliance on purchasing tools and materials from wholesalers versus retailers was also a trend experienced across most provinces, with the sole exception of Nova Scotia. Having said that, the trend has been notably stronger in Alberta, Saskatchewan and Manitoba. These provinces have been growing in economic importance over the last few years, which has likely led to major wholesalers setting up distribution chains accordingly.

### Flood-related boost to renovation demand

Prospects for renovation spending over the remainder of this year and next remain relatively bright. The competing forces of still-reasonable job growth and low interest rates on the one hand and high debt levels and a lack of pent-up demand on the other are likely to lead to overall renovation spending growth in the 3-4% range in 2013 and 2014. The housing market is expected to be a more neutral influence than it has been over the past several years, with home sales and prices likely to remain relatively flat over the next 6-12 months. The forecasted pace of home re-sales is still consistent with roughly $10 billion worth of renovation activity annually.

In the near term, the rebuilding efforts in Calgary and Toronto following the damaging floods that struck in late June and July are expected to lead to a burst in renovation spending. In Toronto, July’s storm mostly led to a sea of flooded basements across the city. The storms in Calgary were far more catastrophic, with over 14,500 homes being damaged, many of which will need to be rebuilt completely. The estimated dollar amount of the damages is not insignificant. Insurance claims are expected to exceed $2 to $3 billion according to the insurance bureau of Canada, while the Alberta government has devoted an additional $1 billion in funding to help support rebuilding efforts. That is not to mention the knock-on effects from additional spending reconstruction may encourage. We estimate that renovations tied to these floods could add about 1 percentage point to the overall tally in 2013 and 2014.

The following year, 2015, is expected to be more challenging for the renovations sector. On top of experiencing a hangover from flood-induced strength over the next two years, demand for renovations will face the dampening impact of a likely increase in short-term interest rates as well as a projected slowdown in the existing home market. Renovation spending in that year is expected to decline by 2%.

Regional trends in renovation spending are expected to be more divergent over the next few years compared to the past. In general, regions with the frothier housing markets – such as Vancouver, Montreal and Toronto – are likely to experience more notable slowdowns in renovation activity. On the other side of the spectrum, Calgary and Edmonton
are two markets that could buck the trend owing to stronger conditions in housing and their more rapidly growing economies. (As already noted, spending in Calgary will benefit over the near term from flood-related rebuilding). Other regional markets are likely to experience relatively flat trends in renovation spending over the next few years.

**Longer-term landscape could shift**

Over the longer term, the landscape for renovation spending is likely to change. In the last few years, renovation projects were likely larger with remodeling projects the most popular type of renovations taken on by households. There will probably continue to be a significant share of remodeling projects. However, the recent string of new homebuilding and renovation spending has left the Canadian housing stock in the best condition in decades. The average age of a home – while still old – has been falling. Meanwhile, the share of homes needing no repairs (as revealed in the Census) is relatively high when compared to history. More work will likely be earmarked towards smaller projects. About 25% of the housing stock still requires minor repairs and maintenance.

While renovations in the last ten years have likely been tied to first time homebuyers and homeowner’s upgrading their current home or a new purchase, the next few years may be defined by a shift in demographics. The Canadian population is aging. It’s been a slow trend, but one that has accelerated since 2011. Theory tells us that as people age, downsizing from a house to an apartment or condo is a common choice. In Canada, however, government tax credits and grants provided to seniors to help improve accessibility has encouraged them to remain in their existing homes longer. This may be one reason why Canadians over the age of 70 years spend roughly $2,000 more on average for shelter (expenses related to rent, homeownership and maintenance) than someone in their 40s. That totals up to an increase in housing expenditures worth up to $2.2 billion dollars over the next three years just due to an aging population.

**Bottom Line**

Overall, while renovation spending is expected to moderate in the coming years, it is likely to remain a bright spot amid a slowing housing sector and declining new home construction.
End Notes


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