



SMARTER PERSPECTIVE: HOME IMPROVEMENT

The Home Improvement Market: Navigating Post-Pandemic Headwinds

By Gary Dressler

After riding the wave of a pandemic-fueled renovation boom, the home improvement industry now confronts a complex web of challenges—from stubborn inflation to the impact of sawmill distress to nearly frozen housing markets. For lenders and investors, understanding how these forces are reshaping consumer behavior will prove crucial in identifying future market opportunities. Specifically, this article explores the circumstances which would need to arise in order for the home improvement market to recover from its current downturn and identifies the adjustments consumers are making in the “Remove and Replace” (R&R) sector—both which serve as indicators for lenders looking to anticipate what’s next.

The Pandemic and the Golden Era of Home Improvement

When COVID-19 and the subsequent national shutdown transformed homes into round-the-clock living and working spaces, it catalyzed an unprecedented surge in renovation spending. The conditions for such a shift couldn't have been more favorable: mortgage rates plunged to a historic low of 2.65%, the Federal Reserve slashed federal funds rates to near zero, and homeownership climbed to 65.8% by 2020—adding 2.1 million new homeowners (a year-over-

year net increase of 2.6%) to the market.

This convergence of factors propelled both professional and DIY segments to new heights. Major retailers reaped the rewards, with Lowe's and Home Depot reporting fourth-quarter sales jumps of 29% and 25% respectively in 2020. The DIY sector proved particularly robust, with spending soaring 44% between 2019 and 2021 to reach \$66 billion—a trend driven largely by younger and budget-conscious homeowners in more affordable metropolitan areas.

Meanwhile, America's aging housing stock reshaped spending patterns. Energy-related improvements—from roofing to HVAC systems—reached \$111 billion by 2021, occupying 34% of all market spending. Climate-related disasters further accelerated this shift, pushing disaster repair spending to \$18 billion in 2021 compared to the previous decade's \$12 billion annual average.

Perhaps most significantly, the pandemic revolutionized how consumers shop for home improvement products, marking a new and lasting preference for ecommerce. Online sales surged from 24% of total market share in 2019 to 37% by 2023. While industry favorites like Home Depot and Lowe's have continued to dominate the space, the widening of

the online market enabled e-commerce giants like Amazon, Walmart, and Costco to expand their collective market share from 35% to 42%—a significant incursion into territory traditionally dominated by specialty retailers.

Market Transformation and Current Challenges

As optimistic as the home improvement market's outlook appeared during the pandemic, today's landscape looks markedly different. With mortgage rates hovering around 6.5% for 30-year fixed conforming loans and the Federal Reserve's benchmark rate at a 22-year high of 5.5%, the market faces strong headwinds. These conditions have created a “lock-in effect,” with homeowners who secured sub-4% mortgages between 2020 and 2021 increasingly reluctant to enter today's higher-rate market—especially given that home prices now stand 20-40% above their levels five years ago.

The ripple effects extend throughout the construction sector. According to the U.S. Census Bureau and the U.S. Department of Housing and Urban Development, full-year 2023 single- and multi-family residential housing starts declined 6% and 13% respectively year-over-year. This decrease is a reflection

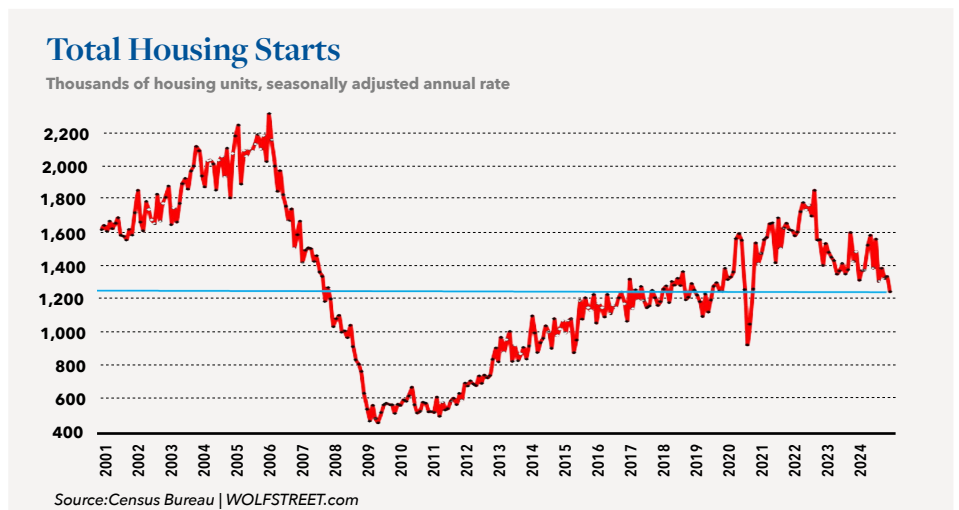
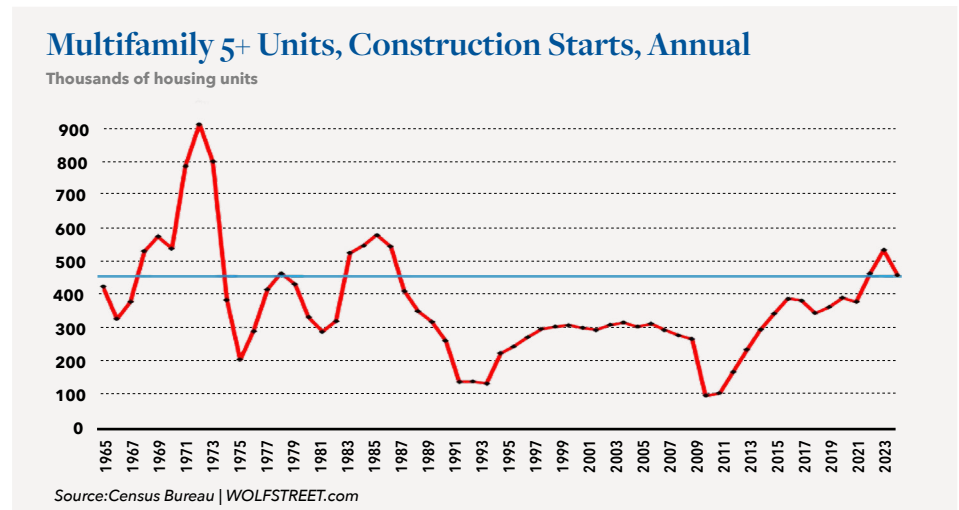
of higher mortgage rates and yet is also partially offset by the demand for new homes due to the existing market freeze.

The multi-family segment's trajectory tells a more complex story. After reaching a 36-year high of 547,400 starts in 2022, the sector now grapples with potential overbuilding in several markets, with 468,600 units started in 2023. Those residences—primarily condominium units and rental apartments—are now reaching the rental market amid growing concerns about oversupply. While this may ease housing costs for renters and condo buyers, it is cause for concern for developers, landlords, and lenders.

Overall residential construction starts dropped by 6.8% in July 2024 from June 2024, representing a seasonally adjusted annual rate of 1.238 million. This year-over-year 16% drop is driven by an outlier drop in single-family starts.

Beyond these challenges, supply-side pressures continue to compound market difficulties. The lumber industry faces particular strain, with rising operational costs pushing many sawmills into the red. North American sawmill capacity contracted by 2% in 2023 as closures outpaced new openings. Industry leader West Fraser Timber has shuttered operations in British Columbia and Florida while limiting production elsewhere; meanwhile, Teal-Jones Group's bankruptcy filing underscores the sector's vulnerabilities.

Adding to these headwinds, an array of tariffs continues to burden the industry. Section 301 tariffs on Chinese imports—first imposed by the White House Administration in 2018—impact 450 building materials and products essential to residential construction, with rates ranging from 7.5% to 25%. Section 232 tariffs on steel and aluminum further strain the supply chain and drive up material costs, while Canadian lumber tariffs impact one-third of U.S. lumber imports—a particularly concerning dynamic given the current state of domestic sawmill capacity. All of these costs are being passed



through to consumers and homeowners with one inevitable outcome: the persistent delay of home improvement projects which might otherwise be undertaken in better market conditions.

True Value's Bankruptcy: A Market Bellwether

The October 2024 Chapter 11 filing of True Value, a 75-year-old hardware store brand, serves as a stark indicator of the industry pressures rippling through the home improvement sector. The company's agreement to sell most operations to rival Do it Best for \$153 million, while carrying debt between \$500 million and \$1 billion, not only reflects its own financial struggles but also illuminates the mounting challenges facing traditional hardware retailers in an

increasingly complicated market.

The timing of True Value's restructuring is particularly telling. Coming amid the aforementioned rising interest rates and declining consumer spending on home improvement projects, this shift suggests that mid-sized players are finding it increasingly difficult to compete with industry giants Home Depot and Lowe's. True Value's cooperative model—supporting independently owned stores with wholesale distribution and marketing services—proved vulnerable to the industry's shifting dynamics, including the rapid growth of e-commerce and changing consumer preferences.

The bankruptcy also highlights the particular challenges faced by



cooperative business models in the current economic climate. True Value's member-owners, many of whom have operated their stores for generations, now find themselves at a crossroads. The Do it Best acquisition may provide needed scale and technological infrastructure, but it also represents a fundamental shift in the competitive landscape of hardware retail, where size and efficiency increasingly determine survival.

For industry observers, True Value's restructuring serves as a warning sign about the broader vulnerabilities in the home improvement retail sector. As consumers continue to grapple with inflation and higher borrowing costs, and as online competition intensifies, more consolidation may be inevitable. The question remains whether this trend toward consolidation will ultimately benefit consumers through improved efficiency and purchasing power, or lead to reduced competition and fewer choices in local markets.

Market Evolution and Consumer Adaptation

The Leading Indicator of Remodeling Activity (LIRA) projects a \$30 billion spending decrease through Q3 2024, with homeowner renovation intent dropping from 55% to 52% year-over-year. This broad decline has hit industry leaders hard—Home Depot reported a 3.3% drop in comparable sales (versus a forecasted 1% decline), while Lowe's experienced a steeper 5.1% fall.

Yet this downturn masks important nuances in consumer behavior. While large-scale, debt-financed renovations have slowed significantly, certain segments show remarkable resilience. Essential maintenance continues to drive steady demand, while energy efficiency upgrades—including smart thermostats, energy-efficient windows, tankless water heaters, energy-efficient appliances,

HVAC system upgrades, and LED lighting—remain popular as homeowners seek long-term cost savings.

The aging-in-place modification segment has emerged as another bright spot, with homeowners increasingly investing in features like grab bars, non-slip flooring, and curbless showers to accommodate aging household members. These targeted improvements often represent more manageable investments than comprehensive remodels while addressing crucial functional needs.

Looking Ahead: Implications for Lenders

The Federal Reserve's September 2024 decision to cut rates by 50 basis points to 4.75%-5% marks a potential turning point, though the market's response remains complex. Lower rates could stimulate activity through several channels: more attractive home equity loans for remodeling projects, potential increases in home sales volume, and improved consumer confidence for undertaking improvement projects.

However, lenders and investors must navigate significant structural challenges beyond interest rates. The residential construction market's cooling from its frenetic 2021-2022 pace has created divergent concerns across sectors. Of particular note is the multifamily segment, where a construction surge reached multi-decade highs and now raises fears of substantial overbuilding. These newly completed units—predominantly high-end condos and rental apartments where developers saw the strongest margins—are entering a market already showing signs of strain. The commercial real estate sector's year-long depression adds another layer of complexity, though early indicators suggest multifamily construction may have found its bottom this spring after significant contraction from boom-time levels.

This market evolution creates several key considerations for lenders. The eventual erosion of the lock-in effect could reshape demand for building supplies, while any renewed pressure on rates might further suppress discretionary spending on home improvements. Success in this environment requires careful monitoring of improvement margins, product turnover rates, and trade policy impacts. Lenders must also consider how the potential oversupply in certain market segments—particularly high-end multifamily developments—might affect both property values and renovation demand in those sectors.

While the sector's fundamental drivers—including an aging housing stock, climate-related repair needs, and demographic shifts—remain intact, near-term navigation demands particular attention to how consumers are adapting their renovation strategies. Understanding these evolving patterns, especially in markets where new construction may have overshot demand, could prove key to identifying opportunities amid the market's transformation. The challenge for lenders will be distinguishing between markets where current weakness reflects temporary conditions versus those facing more structural challenges from overbuilding and shifting demand patterns.



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