Renovation/Rehabilitation: A Growing Market for the '90s

The slowdown of new construction has many wall and ceiling subcontractors scrambling to keep busy. Often they have responded by bidding on more jobs, making lower bids than they would normally, restructuring their companies for greater efficiency (selling off equipment or reducing staff size and payroll), and shaving their profit margins to the bone.

One area of construction, however, has been growing steadily over the past years, and that area provides some comfort for those in the wall and ceiling industry who are able to service the market and capitalize on it. The area is renovation and rehabilitation, both in the commercial and residential sectors.

Renovation/rehabilitation appeals to many wall and ceiling subcontractors. It often enables them to utilize products and skills which are more profitable and not as competitive as new construction. Renovating a very old building, for example, may mean plastering and detail work that is highly labor intensive and requires a high level of technical skill. Even renovation of buildings no more than 10 to 20 years old can require problem-solving capabilities not needed in new construction.

Both residential and commercial sectors are seeing growth in renovation and remodeling.

Commercial Renovation

New commercial construction, which includes office buildings and retail stores, peaked in 1985 and has declined every year since, according to Robert C. Doran, director of marketing research and planning for Cold Bond Building Products. In terms of floor area awards, this important category is now half of what it was in 1985. Yet a surplus of commercial space remains, primarily as a result of overbuilding during the tax shelter years. Vacancy rates remain high even after declines in office construction.

The one bright spot for the commercial market, however, is renovation. “In 1986, the U.S. Department of Commerce estimated that the commercial renovation and remodeling market had a value of about $78 billion,” Doran said in late 1990. “It is estimated that this market is now approximately $100 billion and will probably continue its upward climb while the economy is weakening.”

Why is commercial remodeling growing? Several factors seem to be influencing this trend: (1). With high vacancy rates and new buildings available, even buildings a few years old...
need to undergo large-scale renovation to attract and keep tenants in the marketplace. (2) Incentives are still available for renovation of designated historical buildings. (3) Given the high costs of land and new construction, even major alterations to existing buildings will usually be less costly than new construction. Owners and developers are finding that it makes economic sense to renovate a building rather than tear it down and put something new in its place. (4) Financial institutions all across the country are becoming loaded with problem real estate projects—either incomplete new projects for which the developers were unable to finish or buildings that have returned to the financial institutions because of non-payment. Often these projects can be remodeled and put up for business with a minimum of investment. (5) Finally, changes in regulations, particularly fire safety and handicapped access needs, have meant that even recently erected buildings will need updating. This work often involves wall and ceiling contractors at various stages.

One of the economic lessons of the 1980s is that office building construction can be a reaction to financing availability rather than demand for office space. The success record of investments in real estate versus investments in stocks and other alternatives in the 1950s, '60s and '70s created pressure by insurance companies, banks, investment brokers and pension funds to put money into commercial real estate. Developers were more than willing to take this money and build. The result has been an overbuilt market, not to satisfy a demand for additional office space, but to satisfy a demand for building investments.

The availability of new office space at very favorable rates has attracted tenants. This movement into new office space with few tenants available to take the vacated space has led to the newest office building management term, “tenant retention,” and to increased renovation.

Tenant retention is a program to keep existing tenants by making the value of the building to the tenant’s business more than just the space to house the business. Tenant retention programs have introduced building amenities such as day care centers, fitness facilities, concierges, newsletters and tenant appreciation events. Introducing these into the building's operation makes that building important to the tenant’s business. A
tenant retention program also involves renovating the building to avoid obsolescence.

According to a recent survey of Buildings magazine subscribers, 91% of the respondents indicated their firms are currently involved in remodeling/modernization projects or are planning to do so in the near future. Buildings reaches more than 42,000 building development, ownership and facilities-management professionals who are responsible for at least 100,000 square feet of space in the commercial/institutional marketplace.

Office buildings topped the list of building types currently undergoing modernization, with a 68% response, followed by shopping centers at 20% and hospital/health care buildings and apartment/condominiums, each at 16%. The forecast indicates that respondents plan to spend $125.4 billion in 1991 on new construction and modernization; of that figure, commercial building owners and developers indicated they will spend a record $67.7 billion on modernization projects in 1991.

**Residential Remodeling**

Residential remodeling is also expected to increase in the near future, with a pace that could exceed 1990’s estimated $106 billion. This remodeling growth is being driven by several factors, including the following: (1) Demographic trends indicate that much of the growth in our population will come in the 35-54 age bracket, and household heads between the ages of 35-54 tend to spend higher percentages of their incomes on remodeling, (2) Economic factors also appear to support residential remodeling. As house price increases moderate and mortgage rates continue in the 10% range, there may be more incentive for homeowners to renovate their existing homes rather than trading up with hopes of making a large profit as they did in previous years.

The residential remodeling market is usually classified into three segments: (1) About 40% of total spending is for maintenance and repairs, such as fixing a leaking roof, and many of these jobs are do-it-yourself activities. (2) Major replacements such as a new furnace, new plumbing or siding, account for approximately 20% of the total. (3) Additions and alterations, such as a new room or big kitchen or bathroom remodeling projects, account for approximately 40%. However, additions and alterations are usually considered discretionary as they can be easily postponed.

A number of research studies have been conducted on remodeling. Most indicate that kitchen and bathroom remodeling are the most common addition/alteration projects. Also, remodeling expenditures tend to be higher in areas with older homes. Therefore, the Northeast and Midwest have a higher level of spending per household for remodeling than the southern part of the country.

Remodeling activity in the first quarter of 1990 reached a seasonally-adjusted annual rate of $114 billion—a record high. It is estimated that remodeling activity in 1990 will total $106 billion, which is about 5% above 1989. The current year should show continued growth with residential repair and remodeling increasing to about $109 billion, a slightly slower rate of growth than in 1990. This is primarily due to a drop-off in the additions and alterations segment resulting from a projected economic slowdown in the coming year.