

Economic Environment

"Demographics Help Explain the Housing Market" by Al Schuler

According to Professor David Foot, author of the immensely popular book, *Boom Bust Echo*, "demography, the study of human populations, is the most powerful—and most underutilized—tool we have for understanding the past and to foretell the future." There are two key assumptions in demographic forecasting: (1) the number of people in each age group or cohort, and (2) the probability that each person will participate in a given behavior. We can forecast age group or cohort population easily because it is guaranteed to change—people age one year at a time. Participation rate is two-thirds predictable and that is why Dr. Foot claims that demographics can explain two-thirds of everything. In other words, we can be two-thirds sure that a 45-year-old in 2005 will behave the same as a 45-year-old in 1995. Yes, some behaviors change (e.g. health concerns reduced smoking "participation" rates), but most participation rates are stable over time.

Okay, so what? The significance of demographics is that we can forecast trends for our products with reasonable accuracy and that should help us to better serve our customers and become more profitable. We know that about 70 percent of the softwood lumber consumed in North America goes into residential construction with roughly equal amounts in new housing and remodeling. We also know from studies by the National Association of Home Builders (NAHB) that most of the money spent on remodeling is by people between the ages of 45 and 64, and those demographics are favorable. (See Figure 1 and ["Don't Forget the Remodeling Market—It's Just as Important as New Housing," WOODWORDS, May 2000.](#))

Furthermore, we know from history that people

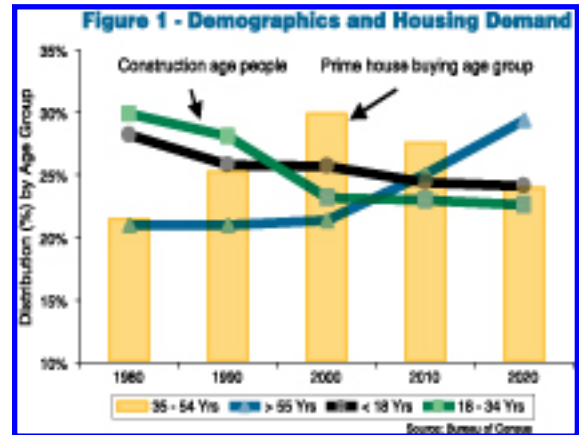


FIGURE 1
CLICK ON IMAGE FOR LARGER VIEW

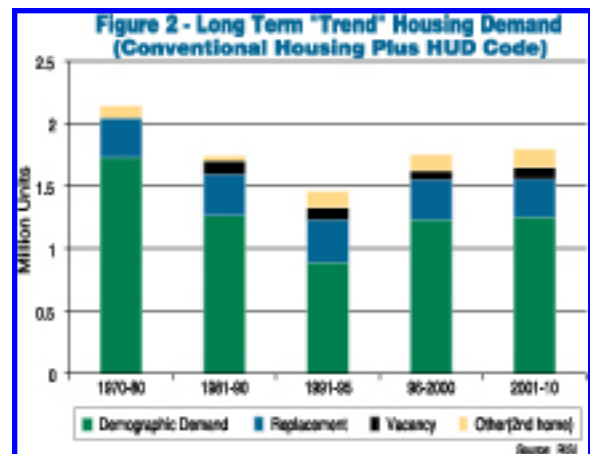


FIGURE 2
CLICK ON IMAGE FOR LARGER VIEW

between the ages of 35 and 54 buy the majority of homes. By observing the downward trends with 18 to 34-year-olds, we know that the current shortage in skilled construction labor will only get worse over the next decade and this has positive implications for labor-saving engineered wood products demand, manufactured housing and building components like trusses. (See ["Engineered Wood Products: A North American Phenomenon,"](#) *WOODWORDS* June/July 2000)



FIGURE 3
CLICK ON IMAGE FOR LARGER VIEW

Although demographics are important, there are other factors impacting long term or "trend demand" for shelter. (Remember, demographics provide only two-thirds of what we need to know.) These other factors include replacement demand (replace demolished home), vacancy demand (unsold inventory) and second home demand. Figure 2 shows that "trend" or "sustainable" demand for new housing is solid and totals approximately 1.8 million units annually according to Resource Information Systems, a Boston-based economics consulting group. The demographic aspect improves thanks in part to favorable immigration trends; replacement demand stays strong as the existing housing stock ages (over 100 million units), and the demand for second homes improves as discussed below.

VACATION HOME MARKET

Let's take a closer look at the vacation home (second home) because it is an important factor driving today's hot housing market. Second home sales last year were 377,000 single family homes (including both new and existing home sales), up over 9 percent from 1997 as determined by the latest survey by National Association of Realtor's (NAR) Economic Research Group. This isn't all demographics as tax law changes, effective in 1997, have allowed most sellers to exclude up to \$500,000 in capital gains from taxation. As noted by the NAR study, this allowed buyers, particularly older baby boomers, to trade down to a smaller primary residence and use some equity to purchase a second home. As baby boomers move through the next decade, these trends will reinforce vacation home sales and push prices higher. (See Figure 3.)

DEMOGRAPHICS, THE ECONOMY & HOUSING DEMAND

As we said earlier, we can't give demographics all the credit. The state of the economy has a big influence on housing demand in the short term. Interest rates, consumer confidence, income growth, and employment status, all affect the "purchase decision." Demographics determine trend demand, but that must be tempered by things like the economy. During good times like the past three years, demand has been above trend (e.g. 1999 housing totaled 2 million units including HUD code, about 200,000 units above trend). Sometimes, demand will fall below trend such as the 1.4 million total during the early nineties recession. The "bottom line" is that demand always gravitates toward the sustainable or trend rate. Use that information to avoid surprises in the future.

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