June 2024

ISSUE #7

THE PULSE

UNDERSTANDING FUTURE DEMAND FOR RESIDENTIAL AND COMMERCIAL CONSTRUCTION

BRANZ

creditworks

FORSYTH BARR

EBOSS

INTRODUCTION

Welcome to **Issue #7 of The Pulse** - your quarterly degustation of local and global insights designed to help you understand the future demand for residential and commercial construction in New Zealand.

Alongside our partners **BRANZ**, **CreditWorks** and **Forsyth Barr**, EBOSS is proud to bring you these series of reports that combine insights and opinions from our expert contributors.

We'd also like recognise the **Ministry of Housing and Urban Development** for their continued input and contributions.

WHAT'S INSIDE?

In order to form a vision of the future, we take available data today and arrange it for analysis over 4 logical stages:

YESTERDAY

Work completed

TODAY

Work under construction

TOMORROW

Work consented, but not yet constructed

FUTURE

Neither consented or constructed yet

Front Cover Illustration Credit: Malcolm Walker

THE PULSE

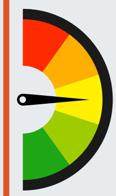
What you need to know in 60 seconds:

YESTERDAY

- Nationwide residential completions still rising - hitting almost 44,000 for 12 months to March 2024, from 43,000 to Dec 2023
- Auckland completions in Q1 2024 were 33% higher than same period in 2023
- Mortgage lending to Investors hits 32-month borrowing high in Jul-2024, August sees OCR cut
- There were 17,442 new mortgage commitments in Jul-2024, up 26% from July last year
- Residential property sales volumes see 5% bump YoY, but median sales price volatile
- Construction cost inflation eases back to 3.3%

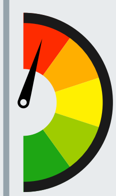
TODAY

- Merchant sales (building, electrical, plumbing) shows signs of resilience when compared to 2023
- The lag between consents issued and construction related sales has widened over recent months to 14 months
- Concrete data shows volume down 11% YOY, but there's signs of stabilisation with last 2 quarters broadly flat
- Days Sales Outstanding (DSO) data suggests builders' cashflow coming under increasing pressure



TOMORROW

- Residential consent approvals are down 16% for Q2 2024 compared to same period last year
- Floor area consented is down 28% on previous year
- Dwelling consents per 1,000 residents now at 6.4, compared to 9.9 in April 2022
- Heat is coming out of residential rental market with prices and number of tenancies easing
- Consents for school buildings has slowed as Government restructure the programme
- 86% of annual commercial consent approvals are for repurposing and upgrading of commercial buildings (office, retail, mixed use)
- The current value of the average industrial building approved is $1.5m



FUTURE

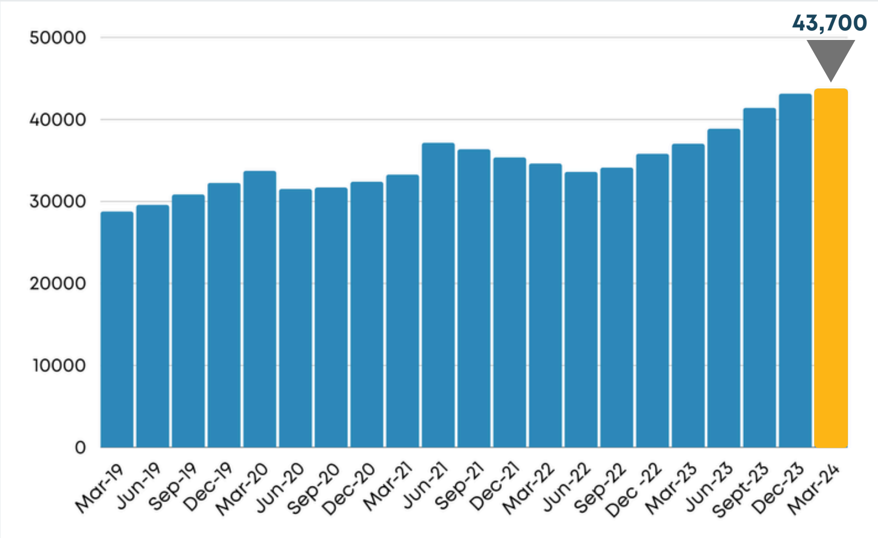
- Unemployment increased to 4.6% in June 2024
- Wages across all sectors grew 4.3%
- Inflation eased to 3.3% in June quarter, from 4% in March quarter - RBNZ target range: 1-3%
- OCR cuts begin earlier than expected with RBNZ trimming rates to 5.25% in their August MPS
- Migration has rolled over its peak and looks to return to pre-pandemic levels of 50-60k
- Headline construction workloads globally gain momentum, with Europe showing signs of recovery
- Dwelling consent forecasts: 30k in 2024, falling to 29k in 2025 before recovering to 36k in 2028
- Despite short term vulnerability, the forecasted value of commercial consents is set to stabilise

YESTERDAY

— Work completed

Based on the Statistics NZ experimental dataset updated in April 2024, the EBOSS/BRANZ CCC (Code Compliance Certificate) model has been updated, and estimates a total of **43,700** nationwide residential completions to March 2024.

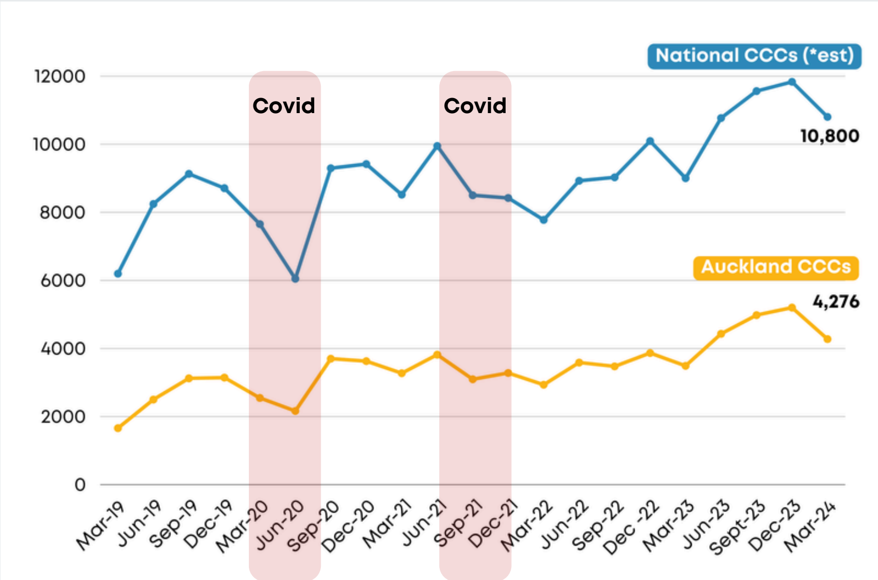
Estimated National CCCs - Quarterly 12-month Rolling
Period: Mar-19 to Mar-24



Source: Stats NZ | BRANZ

- Looking ahead, the high backlog of dwellings from record consent approvals in 2021/22 and extended construction timeframes have driven strong CCC's which we expect to decline over the coming quarters
- Projects in 2022/23 took longer to complete on average with the median time to completion of a stand-alone home exploding from 300 days to 500+ days
- We estimate that over the last 24 months, 8% of residential consents have been cancelled

National Estimated CCCs and Auckland Region Actual CCCs by Quarter Period: Mar-19 to Mar-24

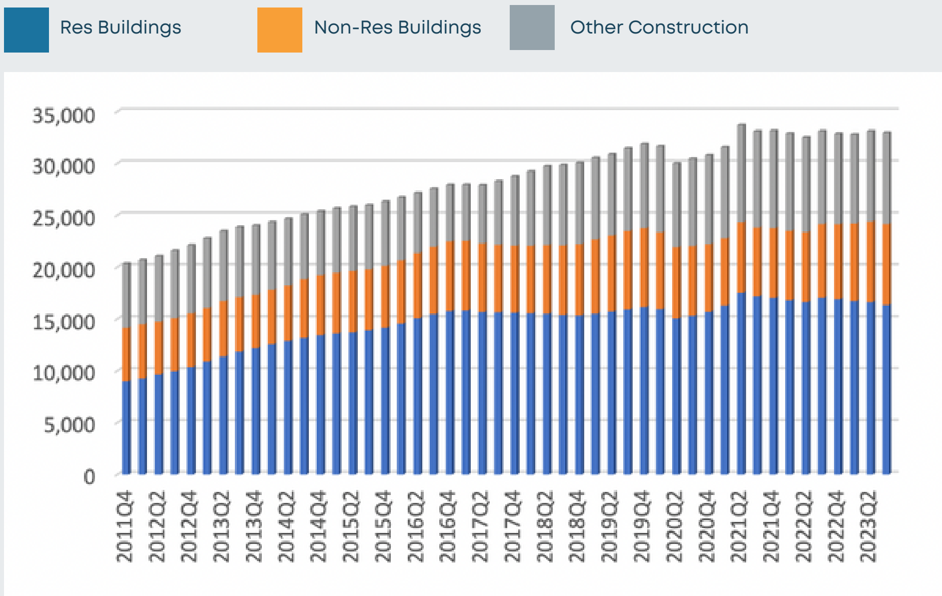


Source: Stats NZ & Auckland Council

- For the March quarter, Auckland Council reported a 33% increase in completed dwellings (CCC's) compared to the same period in 2023
- Over 1,000 more dwellings were signed off by Auckland Council than in the first 3 months of 2023
- By comparison residential consent approvals in Auckland were down 20% for the same period with a 50% decline in apartments and retirement dwellings

YESTERDAY

Gross Fixed Capital Formation Period: Dec-2011 to Dec-2023



Source: Stats NZ | BRANZ

- Construction activity remains strong as measured by expenditure on residential buildings, non-residential buildings, and other construction
- Residential remains the dominant sub-sector, contributing 49% of total activity over the previous 12 months
- Total activity was up by 0.7% from the previous year. Residential has taken the biggest hit, down 4%, but this is largely mitigated by the 10% growth in non-residential activity

Who's Borrowing What - FHB v Investor v Other Owner Period: to Jul-24

	Previous years:		Monthly:				
	Jul 2022	Jul 2023	Mar 2024	Apr 2024	May 2024	Jun 2024	Jul 2024
Total lending ($million)							
All borrower types	5,402	4,997	6,035	5,919	6,909	5,617	**6,652**
First home buyers	1,021	1,238	1,342	1,261	1,480	1,212	**1,415**
Other owner-occupiers	3,471	2,842	3,524	3,391	4,030	3,252	**3,774**
Investors	852	854	1,080	1,188	1,304	1,047	**1,366**
Business purposes	58	64	89	80	95	107	**96**

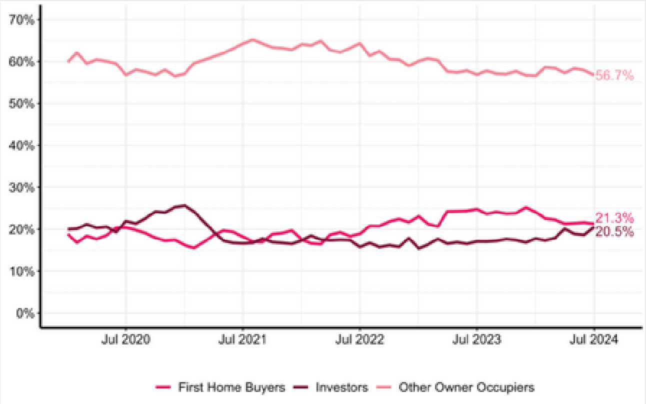
Source: Reserve Bank of New Zealand

- Overall mortgage lending so far in 2024 (Jan to July) reaches $39.5bn
- That's $6bn or ~17% more than the same period last year
- Compared to those record levels seen in 2021, owner occupier and investor activity has fallen back the most, but those measures have strengthened of late

- July 2024 total mortgage lending bounced back 18% from a lull in June to $6.7bn for the month
- Latest data above shows Investors returning with a 32-month borrowing high being recorded in Jul-24
- First Home Buyers continue to remain active in the market and the 14th August OCR cut will only help
- The average gross income for first-home buyers was $151,426 in July 2024, down 1.9% from June
- There were 17,442 new mortgage commitments in Jul-2024, up 26% from July last year
- Of the new mortgage commitments in July, 16.7% of those for first-home buyers had DTIs greater than five times and that was down from 28.6% in July 2023

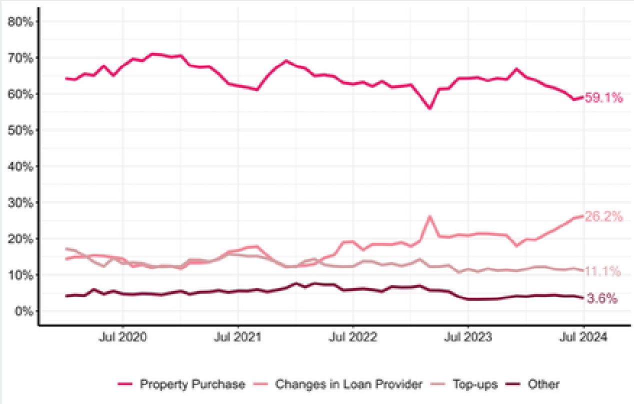
YESTERDAY

Share of Value of Total New Mortgage Commitments by Borrower Type
Period: Jan-20 to Jul-24



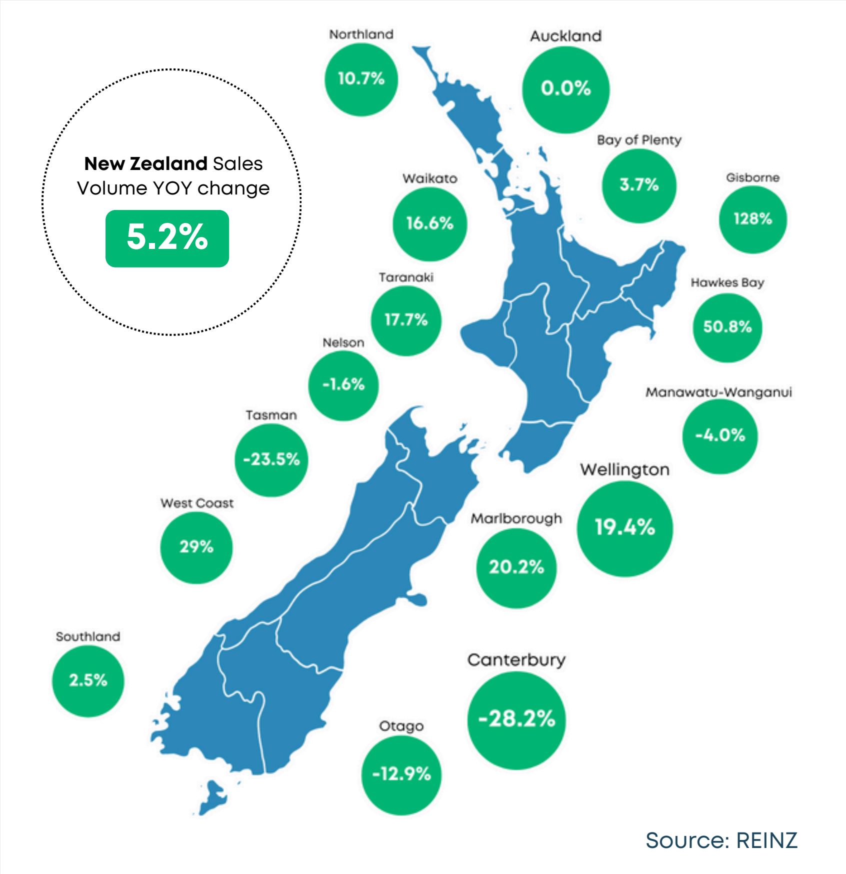
Source: Reserve Bank of New Zealand

Share of Value of Total New Mortgage Commitments by Loan Purpose
Period: Jan-20 to Jul-24



Source: Reserve Bank of New Zealand

Residential Property Sales Volume YOY Change by Region
Period: May-2023 | May-2024 (seasonally adjusted)



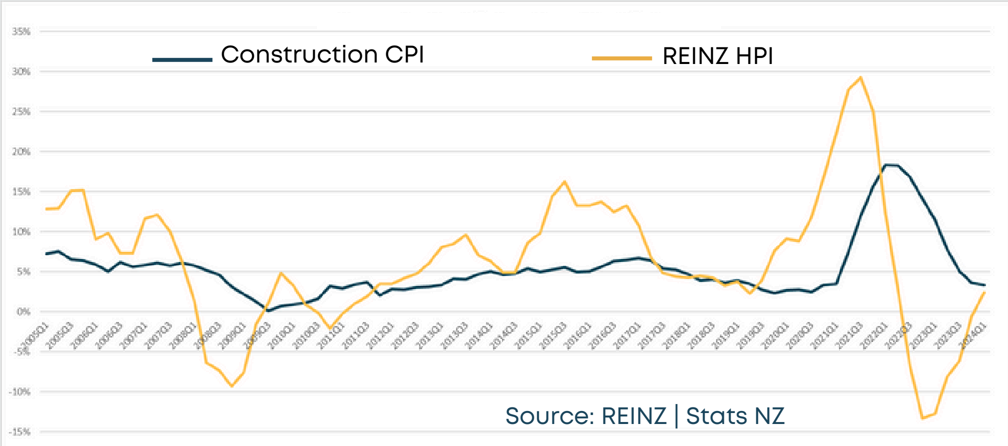
Source: REINZ

- Residential property sales activity across the country has picked up slightly with a seasonally adjusted rise of 5.2% compared to this time last year
- Many of the regions saw their highest monthly sales volumes since 2021, although interestingly Auckland sales were flat
- Some of the largest rises were regions across the North Island, such as Gisborne with a 128% rise (on a small volume of 53 sales)
- Canterbury had a noticeable decline, with 28.2% fewer sales than last May
- National listings for sale remain high, with the inventory for sale at heights not seen since 2015
- Buyers able to secure finance can find themselves in a strong position
- The decline in the House Price Index over the last three months indicates that buyers have the upper hand

YESTERDAY

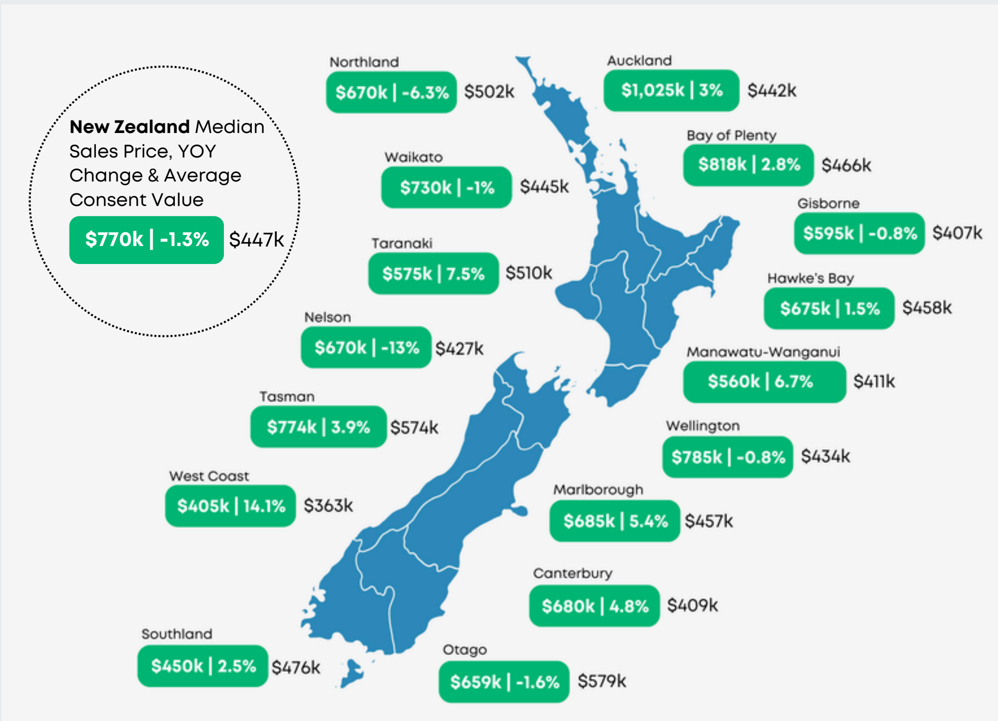
Construction Cost Inflation vs House Price Inflation Period: Q1 2000 to Q1 2024

- Construction cost inflation eased back to 3.3% in Q1 2024 from 3.6% at the end of 2023
- Increased competition in a tightening market may be leading to pencils being sharpened to get new business into the pipeline and so inflation could ease further



- We've only seen the Construction CPI actually fall a few times in the past and only time will tell if we see deflationary costs this time around
- Price stability does remove some uncertainty for contractors pricing future work, who could be more willing to offer fixed pricing
- House price inflation definitely turned positive coming into 2024, making up some of the gap between rising construction costs and the market value of the finished product, but more recent data shows that rate of house price growth has also petered out as continued high interest rates, plus the increasing cost of living, cause housing affordability to be the limiting factor on house price growth

Cost of New Builds v Existing Period: June 2023 to June 2024



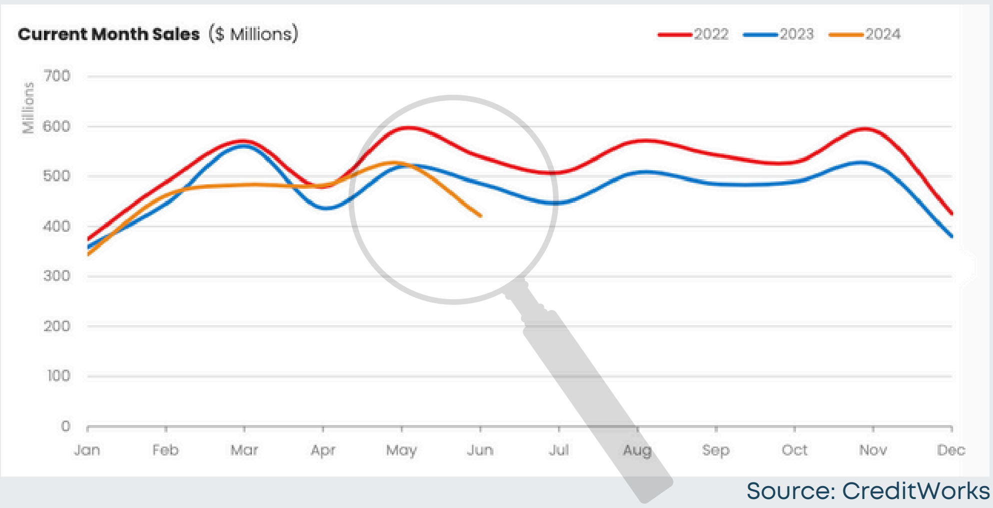
- The median sales price remains volatile across New Zealand
- High interest rates combined with high cost of living means affordability is stretched
- High listing numbers however has enabled a buyers' market so buyers can be more selective and look for lower prices
- The number of consents for new dwellings continues to fall and slight changes in the mix of dwellings types being consented is causing the average consent value to fall, although that doesn't necessarily mean that costs are falling

Source: REINZ | Stats NZ

TODAY

Work currently under construction

Building Merchant Current Month Sales Period: Monthly to **Jun-24**



Month-on-Month

19.9%

Monthly sales decreased by 19.9% from May 2024 to June 2024.

Year-on-Year

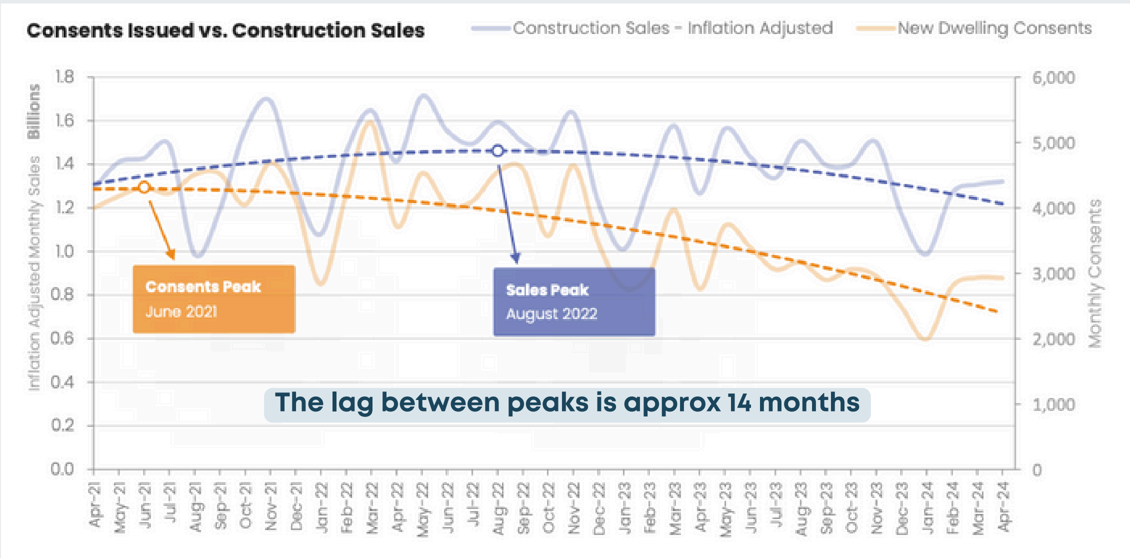
13.3%

Monthly sales for June 2024 were 13.3% lower than June 2023.

Source: CreditWorks

- May's *Building Merchants* Monthly Sales pushed above $500m, on par with May 2023, but June saw that dip more than 13% compared to June 2023
- There's early indication however that July's revenue number will be ~$490m, back with 2023 levels
- June monthly sales for *Electrical Merchants* were down 17% compared to May and down 8% year-on-year, with *Plumbing Merchants* off nearly 20% compared to May, 19% year-on-year
- NOTE: Merchants Sales numbers are not adjusted for inflation

Construction Sales Value vs New Dwelling Consents Issued Inflation Indexed to CPI | Base 1000=Dec-19



Source: CreditWorks | Stats NZ

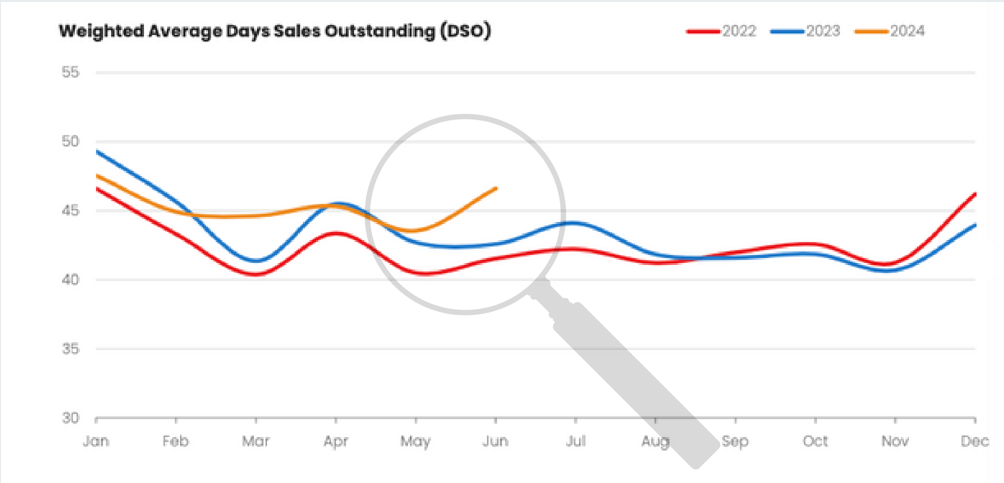
- The chart above aims to monitor the lag between consents issued and construction-related sales, so that consents can be viewed as a more informative lead indicator for when they eventuate

TODAY

- The respective peaks of these trend lines now show a **14 month lag** between consents issued (June 2021) and overall construction sales (Aug 2022) - this has widened over recent months, which we suspect is due to the increase in time to code completion (Stats NZ reported it took on average over 550 days for a standalone house to be completed in 2023)
- June *Building Merchant* data **below** gives us a quick health check with 'Days Sales Outstanding' suggesting that builders' cashflow is coming under increasing pressure - one to watch

Building Merchant Days Sales Outstanding Period: Monthly to **Jun-24**

How long it takes Building Merchants to collect their account receivables



Month-on-Month

7.0%

Weighted average DSO increased by 7.0% from May-24 to Jun-24.

Year-on-Year

9.5%

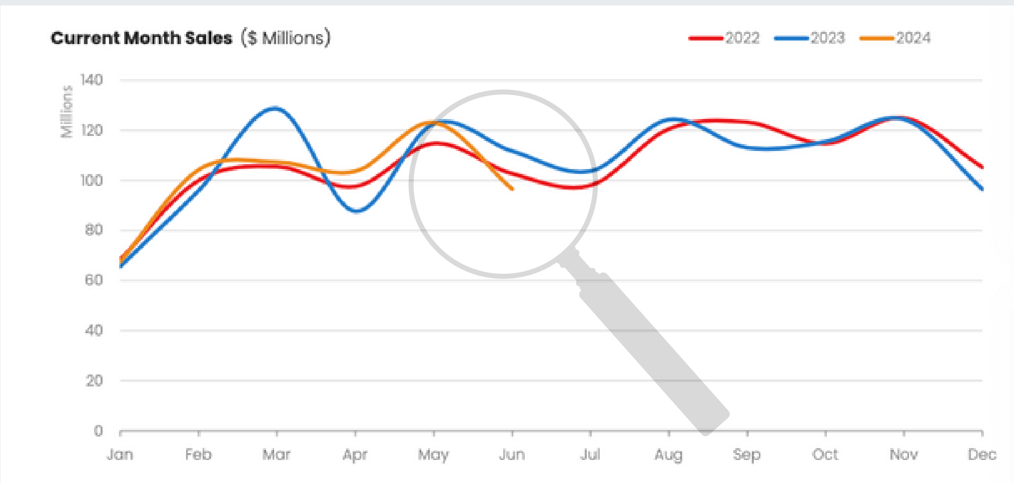
Weighted average DSO was 9.5% higher in Jun-24 vs Jun-23.

Source: CreditWorks

- The chart **below** plots Concrete Merchant Sales - seen as a good barometer of confirmed construction activity and whilst not adjusted for inflation, has been showing some resilience
- June quarter ready-mix concrete (RMC) volumes showed signs of stabilisation, being broadly flat on the prior quarter on a seasonally adjusted basis. On a 12-month rolling basis, RMC volumes are down -11%

Concrete Merchant Current Month Sales

Period: Monthly to **Jun-24**



Month-on-Month

21.6%

Monthly sales decreased by 21.6% from May 2024 to June 2024.

Year-on-Year

13.5%

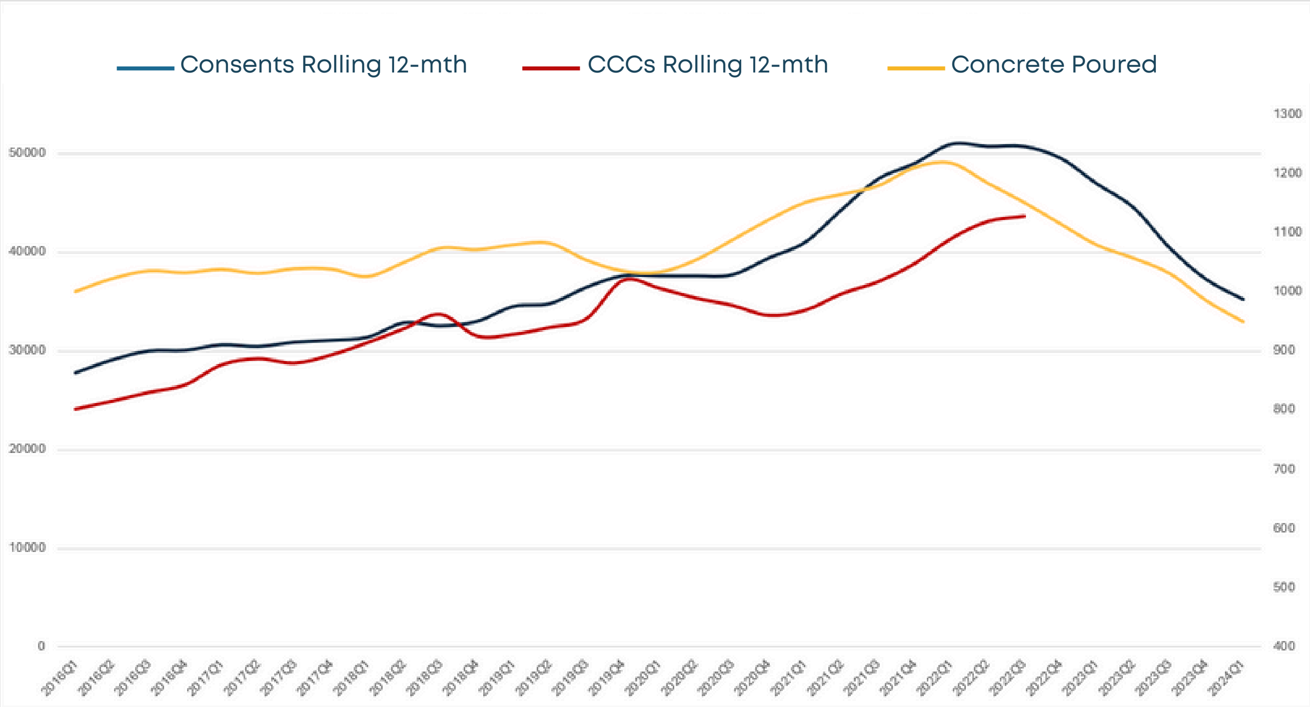
Monthly sales for June 2024 were 13.5% lower than June 2023.

Source: CreditWorks

TODAY

- Whilst building consents are a good indication of the intent to build, the volume of concrete poured can provide a measure of new construction activity with the issuance of Code Compliance Certificates (CCCs) showing the number of completed dwellings
- The chart below shows the rolling 12 months of dwelling consents, plotted against the date the consent was issued
- To help understand the relationships we have brought CCC data forward 18 months, based on 2022/23 median time to completion of 500 days

CCCs Issued (advanced 18 months) v Building Consent Approvals v Concrete Poured (RHS)
Period: Quarterly Mar-16 to Mar-24



Source: Stats NZ | BRANZ Estimates

- Stats NZ's series on the volume of ready-mix concrete produced includes commercial and infrastructure as well as residential, but historically it has tracked residential activity as well

What does this show us?

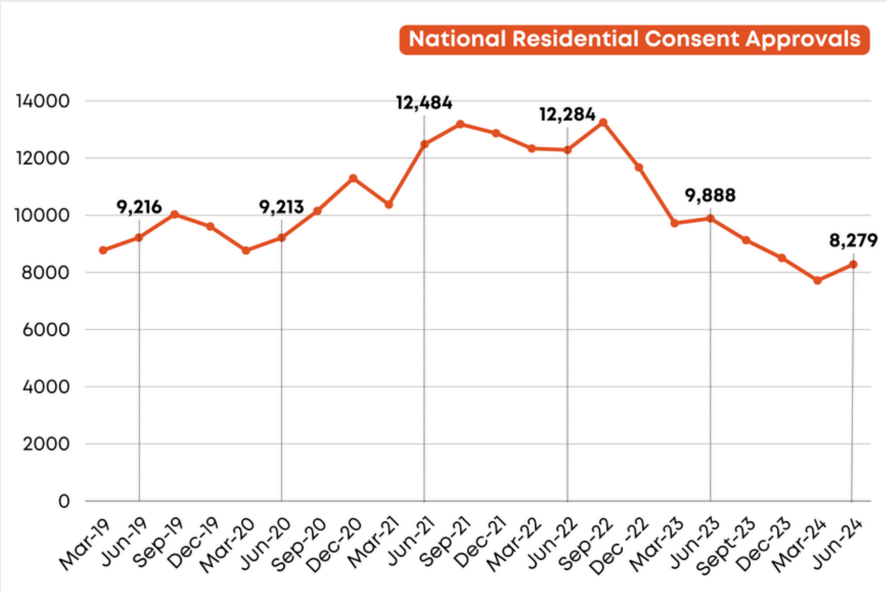
- Consents are our leading indicator. Both consents and concrete production peaked in mid-2022 and have been trending down consistently since then
- With a lack of pre-sales and development feasibility still stretched we would expect consent approvals to continue to trend down for a while yet
- Looking at both the Stats NZ and BRANZ/EBOSS models, it appears completions have finally run out of steam albeit at record levels of 43,700 new dwellings, but based on consent issuance and concrete production falling, we would expect to see completion rates decline at a similar rate from here on in.

TOMORROW

Work consented, but not yet constructed

Quarterly Number of Current Residential Consent Approvals

Period: March-19 to June-24

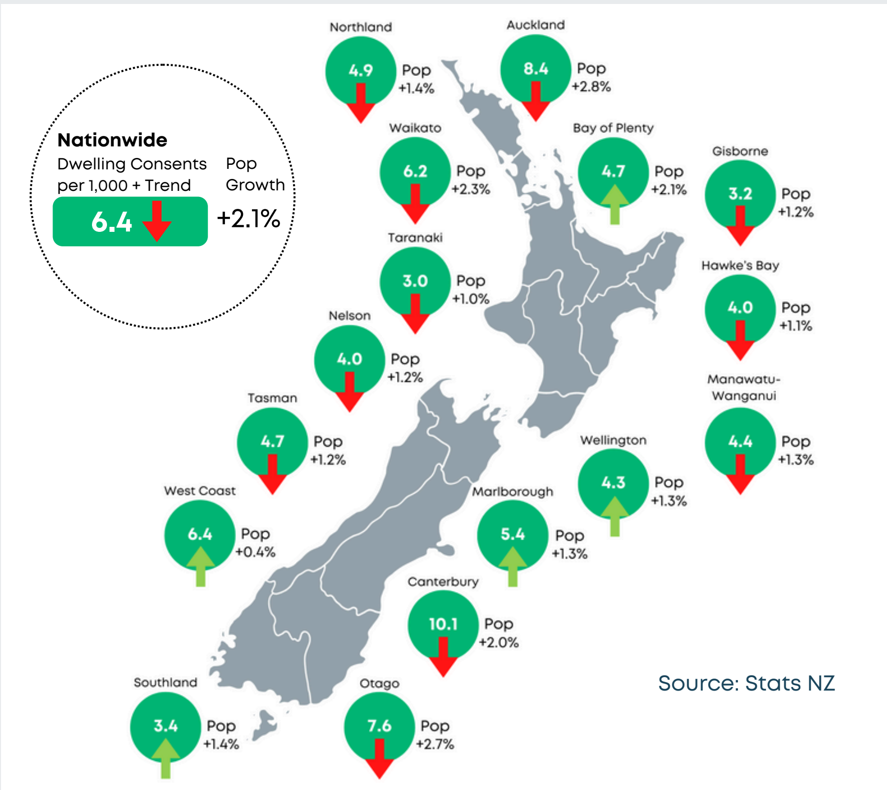


Source: Stats NZ

- Consent approvals are down 16% at **8,279** for the second quarter of 2024 compared to the same quarter last year
- For context, national approvals are now back to levels last seen in 2018
- When thinking about the impact on demand for building materials we should also consider floor area consented. This was down 28% on the prior year

Dwelling Consents per 1,000 Population by Region with Trend Direction and Population Growth

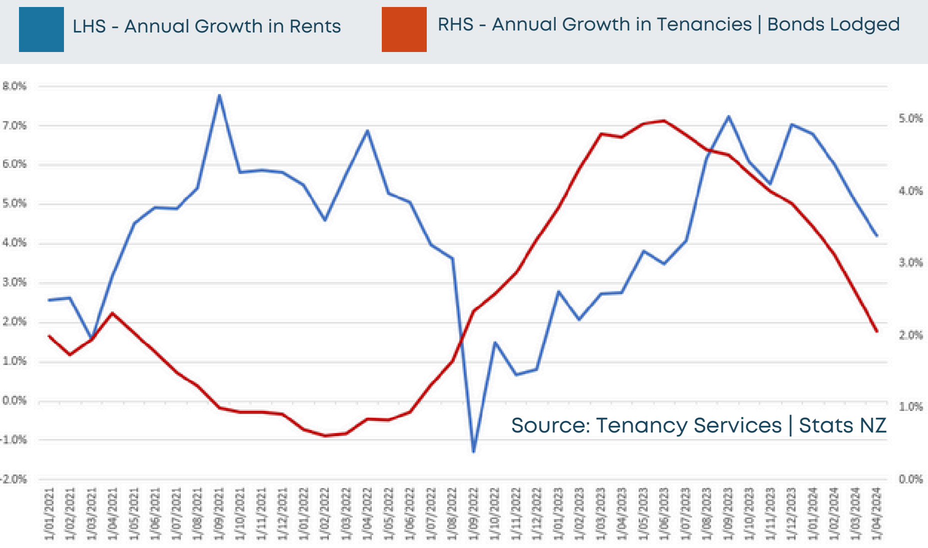
Period: Year to April-24



- Building consents per 1,000 residents continues to decline across most of the country with the national figure falling to **6.4 consents per 1,000**
- This is a significant fall compared to the year to April 2022, where consenting hit 9.9 per 1,000 nationwide
- Auckland has seen the highest level of decline, 12.7 to 8.4, with Canterbury falling from 13 to 10.1
- A few areas buck the trend this quarter compared to the previous EBOSS report, with Bay of Plenty, West Coast, Southland, and Marlborough all seeing a slight rally, albeit from very low numbers of consents
- Wellington is the only metro to see a slight increase

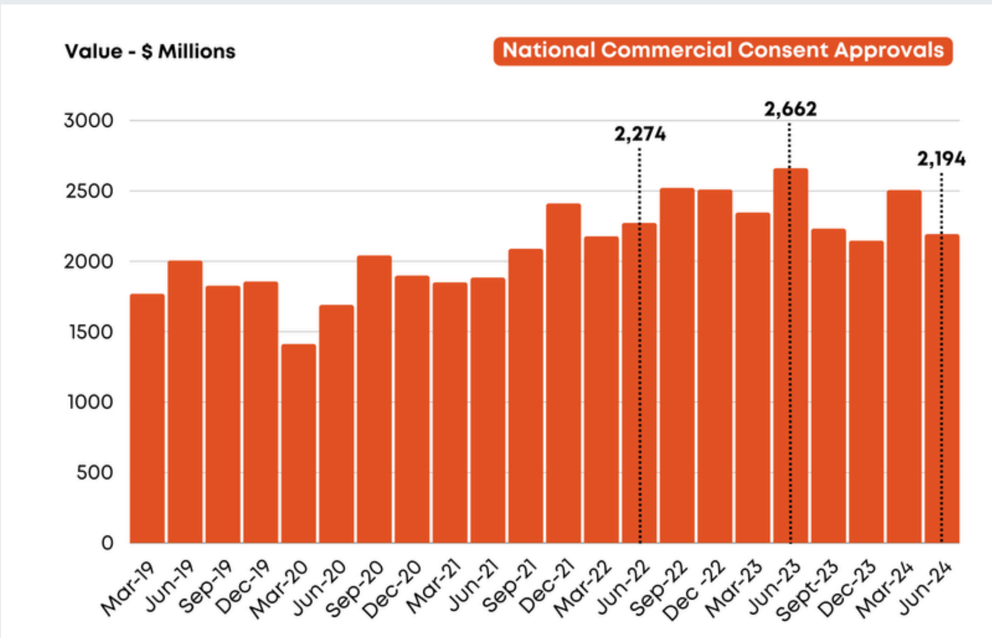
TOMORROW

Rental Bonds Trends
Period: Jan-21 to Apr-24



- The number of tenancies, as measured by bonds lodged with Tenancy Services, continues to rise, but the rate of that growth has eased to around 2% from its peak of 5%
- At the same time the rate of rental price inflation has also dropped away after hitting 7.2% in September 2023 and now sitting at 4.2% in April 2024
- This decline in both the rate of increase in tenancies and rents suggests heat is coming out of the rental market, likely driven by easing net migration and reported growth in rental units

Quarterly Value of Current Commercial Consent Approvals
Period: March-19 to June-24



Source: Stats NZ

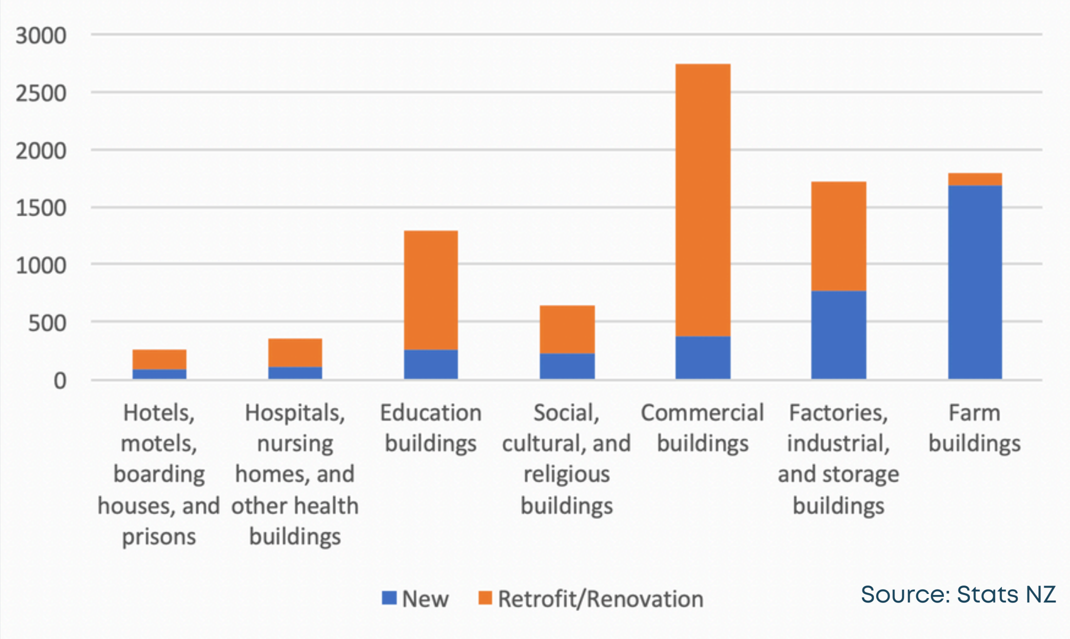
- After a series of weaker quarters, the March quarter lift was led by office, health and industrial projects
- Annually commercial consents are stable at ~$9.1bn, although note that this series is influenced by price changes with non-residential construction prices (as measured by the capital goods price index) up over 4.6% in the year ended March 2024

- Consents for school buildings have slowed recently and a number of school projects have been paused as the Ministry works through their restructuring programme under the new government. The government however set aside $1.48bn to build new schools and classrooms and upgrade existing ones, so look for a rebound in activity

TOMORROW

Number of New Commercial Consent Approvals Year-ending Q1 | 2024

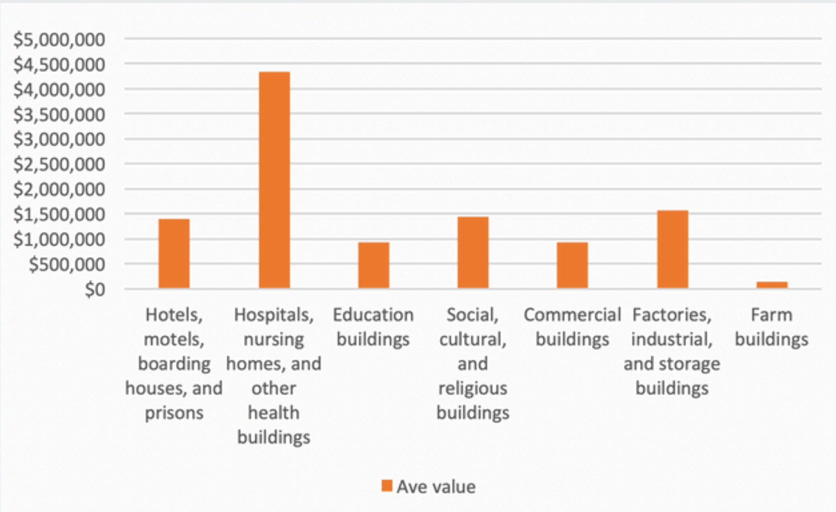
By Type and New vs Refit/Renovation



- There were 2,750 consents approved for commercial work in the March quarter
- The main sector with the highest new build consent ratio was industrial buildings - close to 50% of all consent approvals were for new buildings
- The repurposing and upgrading of our Commercial Buildings (office, retail & mixed use) made up 86% of all project consents issued over the past 12 months
- There were a relatively small number of health building consents in the last 12 months, but the average consent value was high at over $4.3m

Value of Commercial Approvals Year-ending Q1 | 2024

By Type and Average Value



Source: Stats NZ

- Accommodation buildings, social/cultural/religion buildings, and factories/industrial/storage buildings all had an average value of over $1 million
- Although the majority of school and commercial consents were retrofit or upgrading, the value of these projects is still ~$1m
- The average value for approved industrial building consents was $1.5m

FUTURE

Neither consented or constructed yet

- The **unemployment rate** rose from 4% in December to 4.4% in March and on to 4.6% in June. The rise was less than the consensus forecast which means the RBNZ will likely hold in their August meeting
- How the labour market softens from here will be important for when the RBNZ chooses to commence interest rate cuts, which are now increasingly expected to start this year
- We should be aware of regional biases, Wellington building consent approvals are approaching 2016 levels, not helped by the 6,300 job losses in Wellington to date with government restructuring
- Overall **wages across all sectors increased 4.3% year-on-year in the June quarter** as measured by the labour cost index
- **Inflation eased to 3.3% for the June quarter**, down from the prior quarter's 4% and closer now to the RBNZ's 1-3% target range and further triggering calls for OCR cuts to start this year
- Non-tradable inflation remains high at 5.4%, while tradeable inflation is now below 2% for 2 quarters
- The most recent partial data for May highlighted subdued price momentum in food, fuel, air travel, and accommodation

Reserve Bank of New Zealand - Offical Cash Rate Actual and Forecast
Period: 2013 to Sept 2027

Source: RBNZ | MPS = Monetary Policy Statement

- In May the RBNZ said OCR cuts wouldn't start till June 2025, in their August MPS they U-turned and began what is expected to be a series of cuts starting with a drop of 25 basis points to 5.25%
- OCR projections from the Bank (see chart above) suggests the rate will fall to 4.0% by this time next year, and then onto 3% by Sept 2027

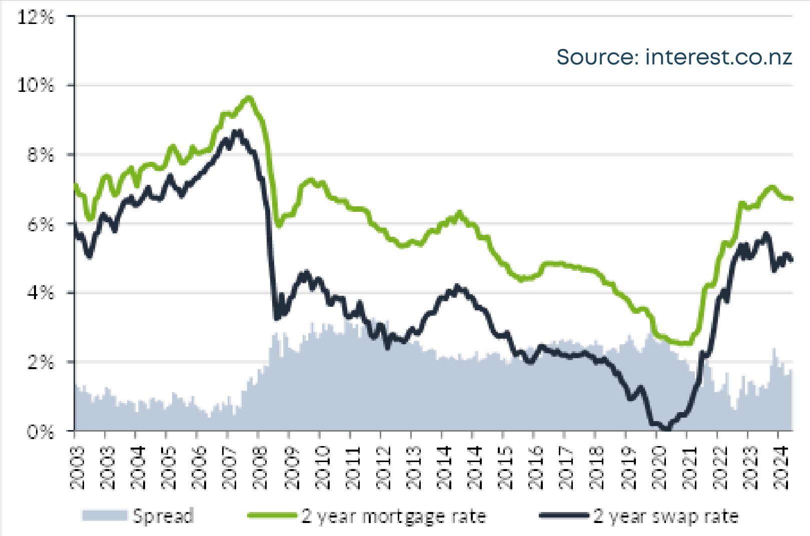
FUTURE

Interest rates

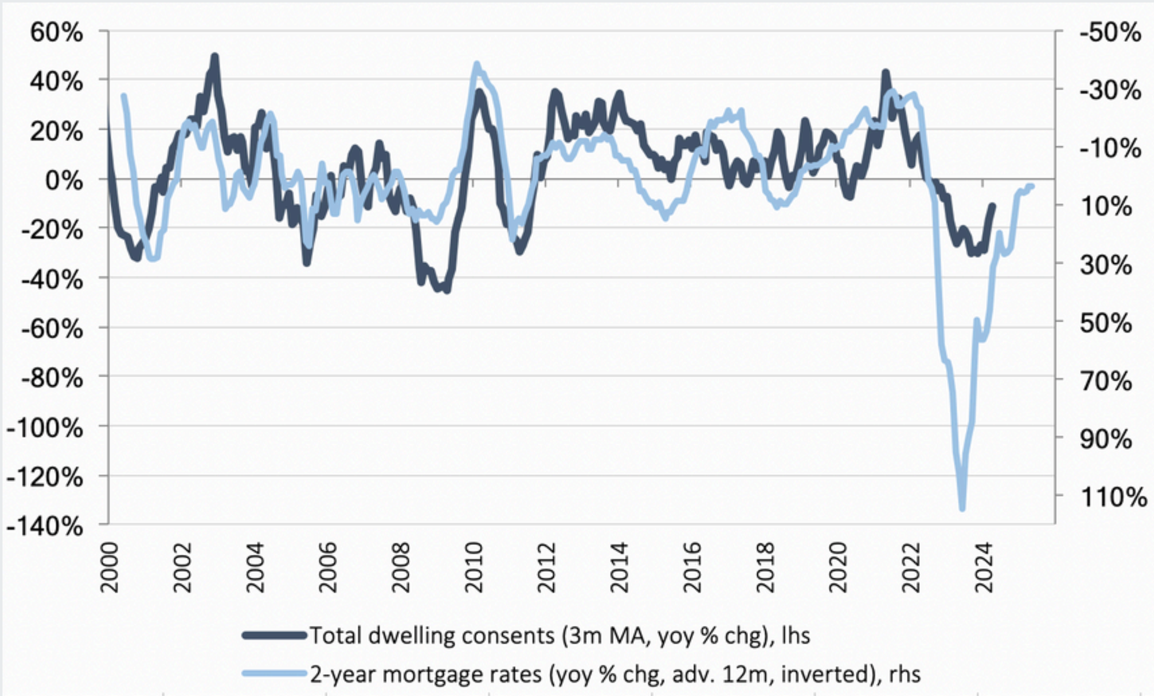
- Home loan rates have drifted sideways over the last three months with bank funding costs (swap rates) increasing slightly as inflation has remained sticky
- The margin between bank funding costs and mortgage rates remains broadly in line with historical levels so reductions in swap rates should translate to lower mortgages relatively quickly
- Interest rates are a key short term driver of housing demand

Mortgage Rates - 2003 to 2024: 2yr Swap & Fixed Rates

'Swap Rate' is the rate at which NZ banks borrow to lend at a fixed rate to the public



Residential Building Consents vs Mortgage Rates - 2000 to 2024

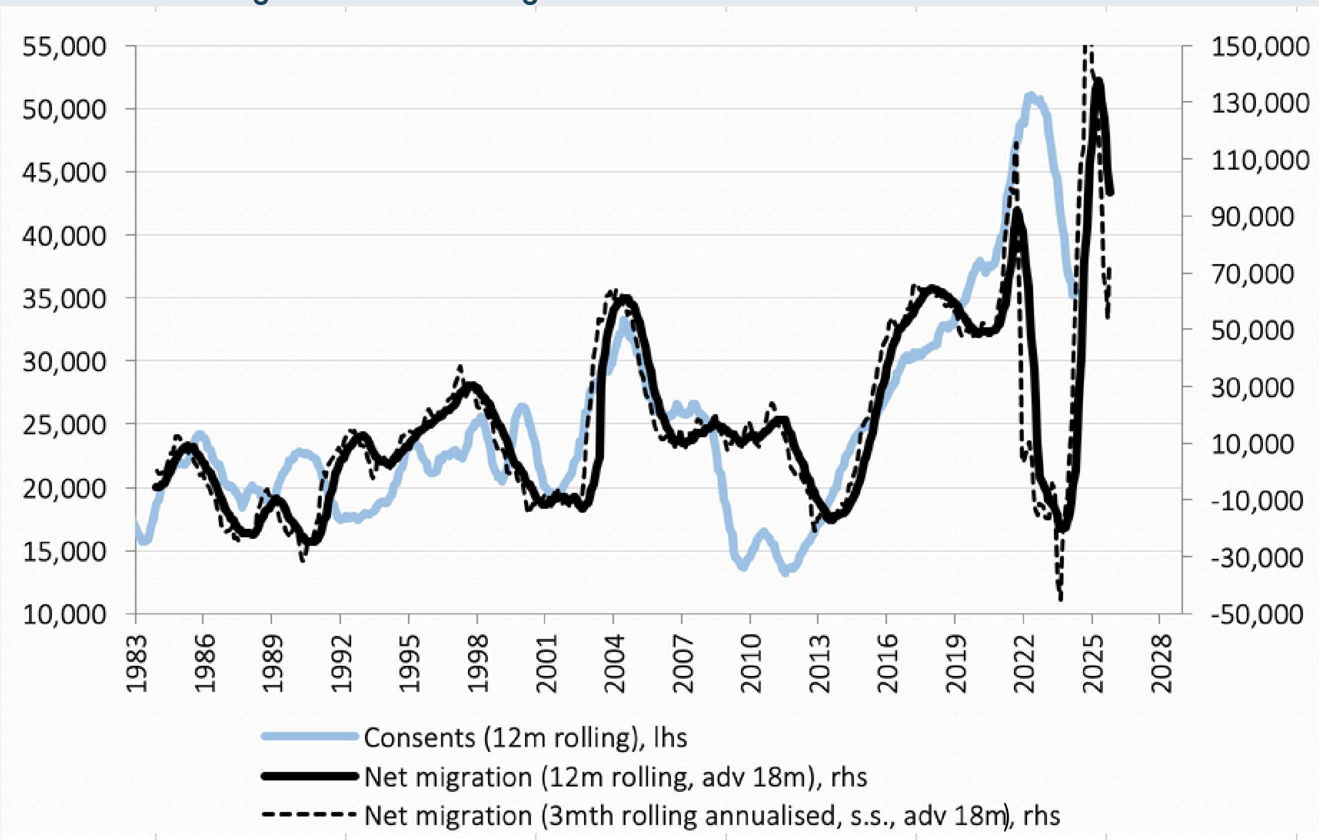


- Historically the change in the level of building consents has had a solid (inverse) correlation to the change in mortgage rates
- Although we note that the volatility in interest rates this cycle has been high and building consents did not fall as far as expected during the recent spike
- The flattening out of mortgage rates over the last 12-months suggests the fall in dwelling consents could stabilise over the next 12 months

FUTURE

Migration

Residential Building Consents v Net Migration - 1983 to 2028 Source: Stats NZ



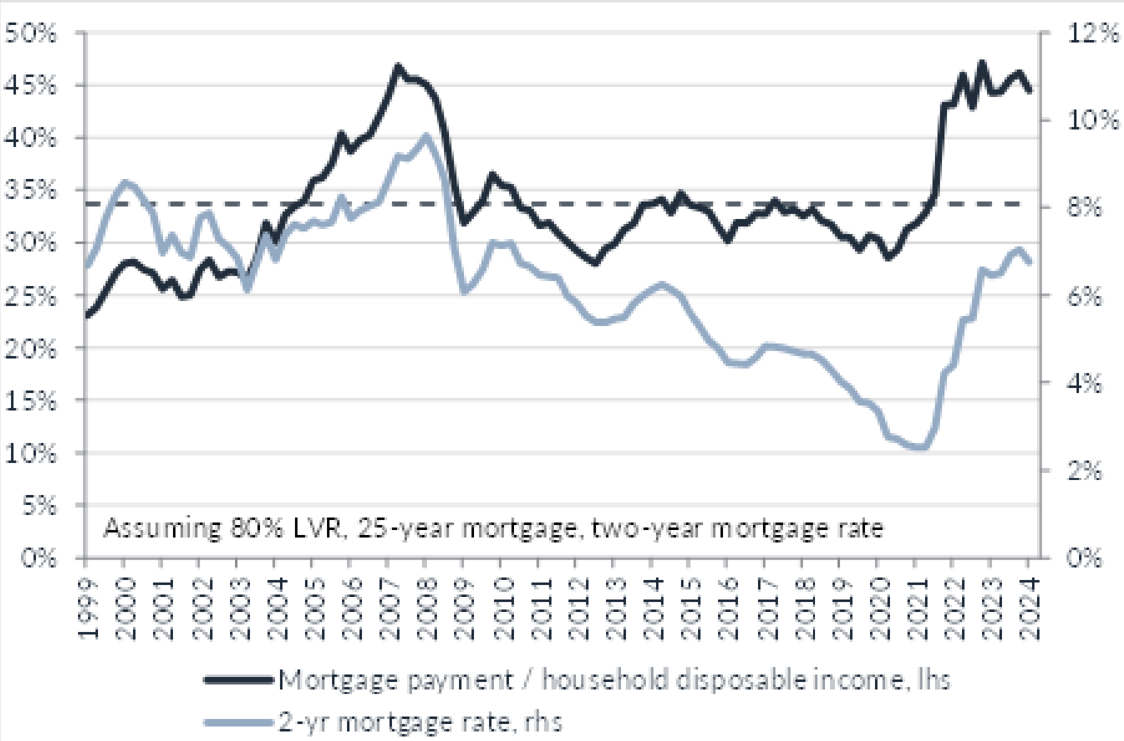
- Migration has clearly rolled over its peak with provisional estimates for the June 2024 year seeing an annual **net migration gain of 73,000**, compared with a net gain of 108,000 in June 2023
- Migration is typically a medium-term driver of housing demand and the RBNZ estimates a 2-year lag between migration and housing construction
- This is broadly consistent with the 18-month lag between migration and residential consents shown in the chart
- Current migration levels and natural population growth suggests around 36,000 to 44,000 dwellings are required based on historical relationships
- Forecasting where migration stabilises is difficult, but assuming this returns to pre-pandemic levels (50,000-60,000) then history suggests **30,000+ dwellings would be required**

FUTURE

Affordability

- Affordability is a key constraint on better housing demand and the following chart highlights the share of income required by the average household to service a mortgage on the average house
- The long run average is for mortgage payments (principal and interest) on the average home to be around 33% of an average household's after-tax income

Mortgage Rates vs Mortgage Serviceability - 1999 to 2024 Source: Stats NZ



- Post the GFC, and prior to the pandemic, lower and lower mortgage rates offset higher and higher house prices meaning the share of income required to service a mortgage had been broadly stable
- Currently our calculations suggest mortgage payments on an average home account for 43% of income - the same level as prior to the GFC
- Scenarios that could return affordability to the long run average include:

  a. **Mortgage rates would need to reduce** ~2.5% to the low 4's, which would be a similar level to where they were in late 2018
  b. **House prices would need to fall** a further 20%, which would be more than a 30% decline from their peak
  c. **Household incomes would need to lift** ~30%, which feels unlikely given to slowing economic backdrop

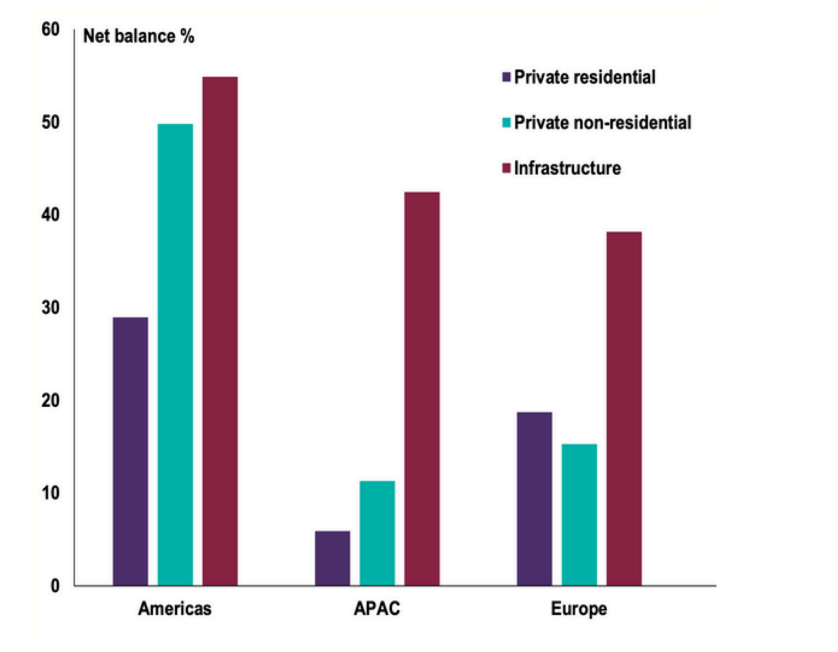
- In our view, it's likely to be a combination of all 3, with interest rates doing the most work

FUTURE

Royal Institute of Quantity Surveyors (RICS) Global Construction Monitor | Q1 2024

- Headline construction workloads globally gain momentum, with Europe showing signs of recovery
- Infrastructure remains the sector with the strongest outlook across all regions

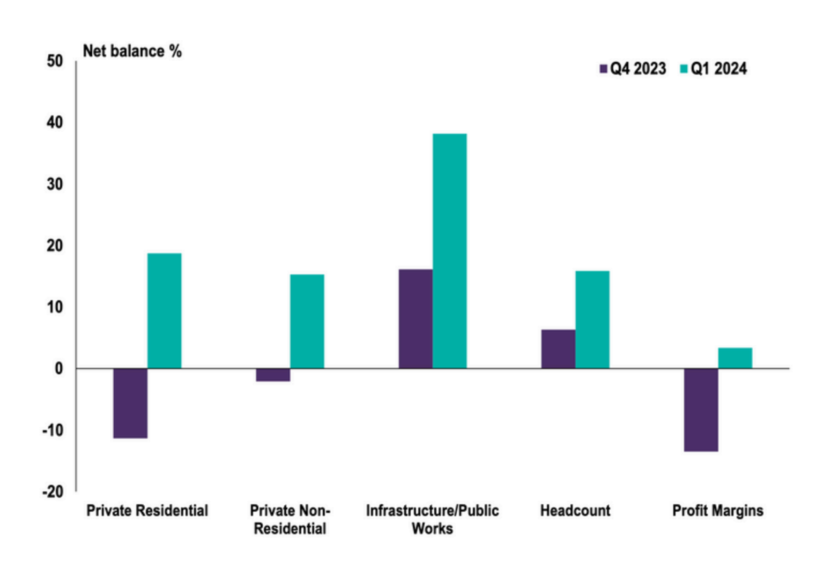
Global: 12-Month Workload Expectations by Region



Source: RICS - GCM Q1 | 2024

- The chart to the left showing the Q1 2024 survey results for workload expectations is particularly good news for Europe, with a previously negative view in Private Residential being reversed
- Meanwhile, across the Americas, 12-month expectations have been upgraded noticeably for both Private Residential and Private Non-residential
- APAC in contrast is quite subdued away from the infrastructure sector, with expected downturns in China, Hong Kong and New Zealand pulling down the average view in the region

Europe: 12-Month Expectations by Sector, Headcount & Profit



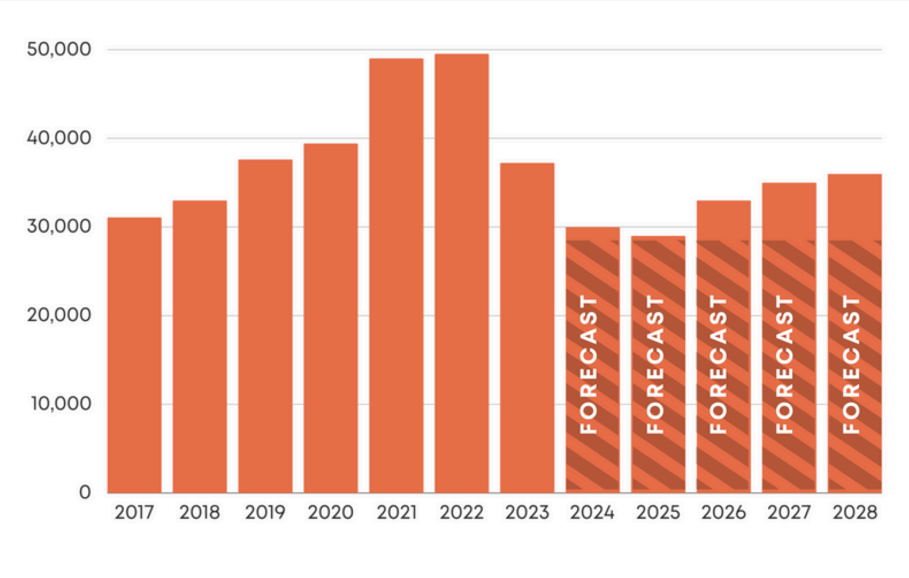
Source: RICS - GCM Q1 | 2024

- Taking a closer look at Europe, and comparing survey sentiment from Q4 2023 to Q1 2024, the results point to a positive outlook for workloads
- Infrastructure spending remains important, but more significantly, 12-month expectations for Private Residential and Non-residential are optimistic across the continent
- And at a headline regional level, the latest profit margin expectations came in positive for the first time since 2021

FUTURE

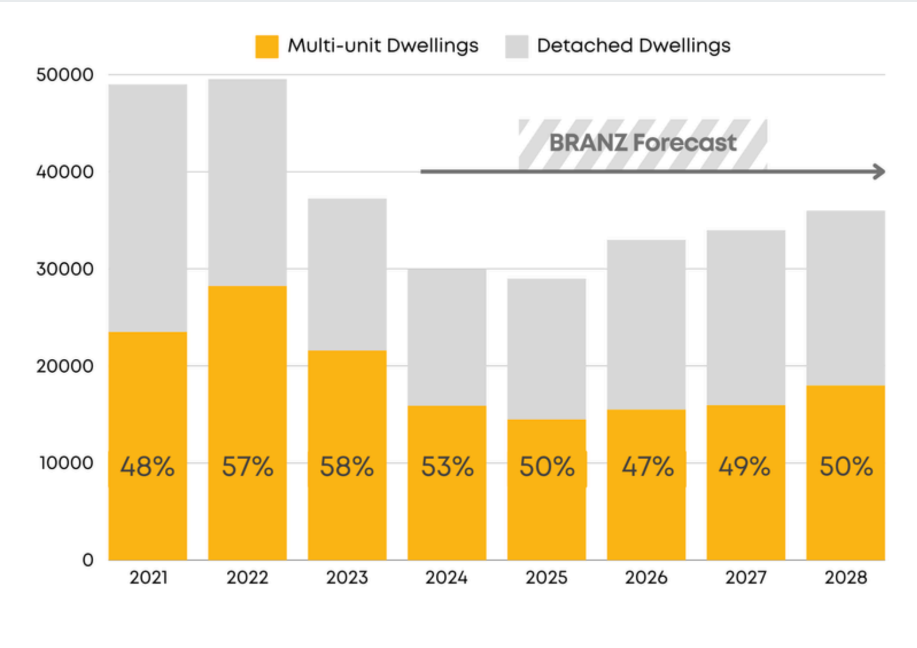
- BRANZ forecast new residential building consents to fall away this year to 30,000 and drop further in 2025 to 29,000
- Kāinga Ora's construction funding is secured through till mid-2026 - but longer term uncertainty surrounds New Zealand's biggest landlord

Residential Dwelling Consent Actuals and Forecasts
Period: 2017 to 2028



Source: BRANZ

Residential Dwelling Consent Actuals and Forecasts
Multi-unit Dwellings vs Standalone Houses Period: 2021 to 2028



Source: BRANZ

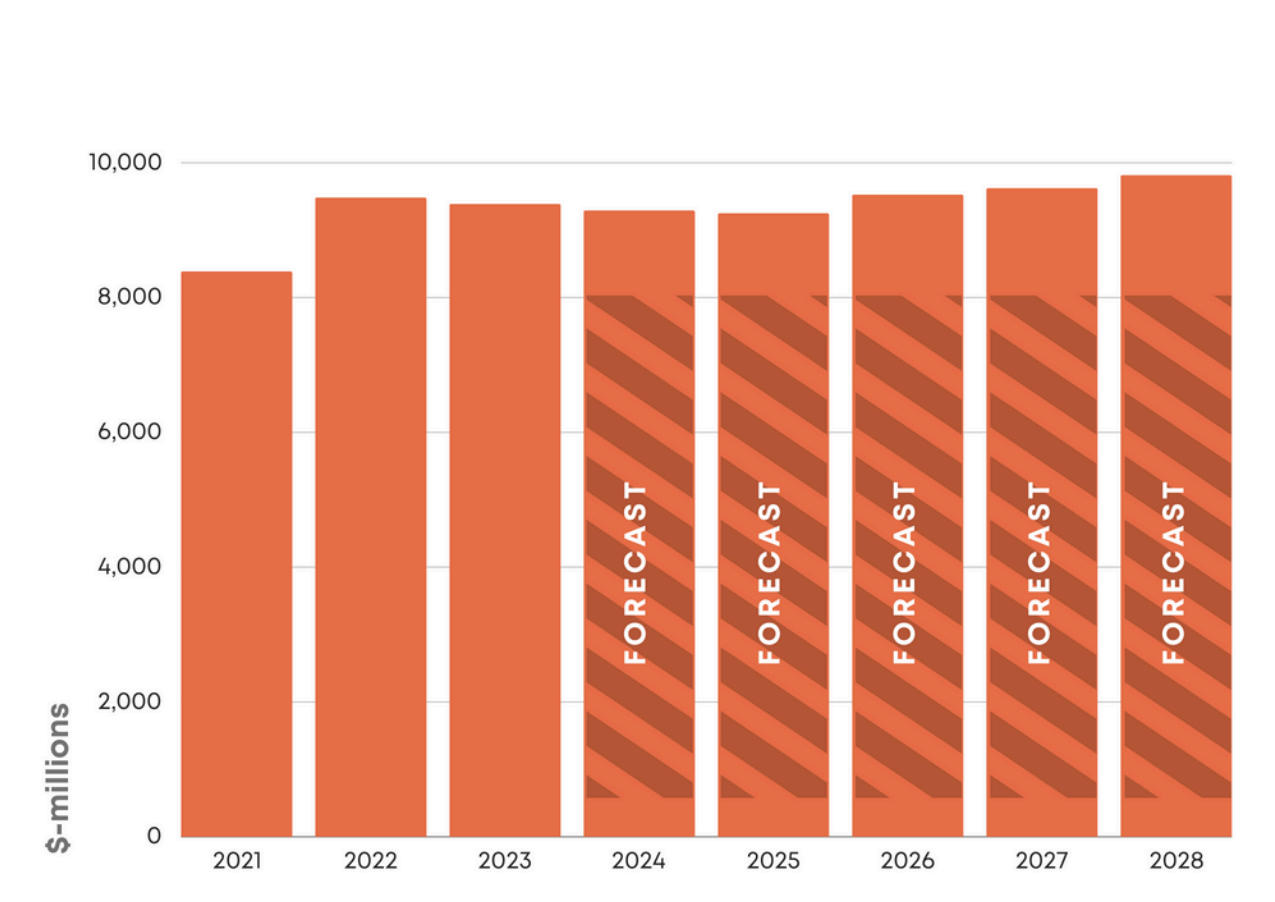
- This drop in residential consents will be largely driven by a fall in consents for multi-unit dwellings, and there's several factors underpinning this thinking:

1. Banks will typically require pre-sales for multi-units which are currently difficult
2. Standalone dwellings are more resilient to changing economic conditions than multi-units
3. Consent completions have remained higher for longer, due to the record multi-unit approvals, and the longer lag time between planning and completions for multi-units
4. High development costs can make the feasibility of brownfield development uneconomic
5. And likely changing government policies from infill housing to greenfield developments will impact too

- The outcome is for standalone housing to represent 50% of dwellings consented over the next 5 yrs, rather than ~45% over the previous few years

FUTURE

BRANZ Annual Commercial Consents Value - Actuals and Forecasts - *not adjusted for inflation*
Period: 2021 to 2028



Source: BRANZ

- We expect non-residential activity to remain relatively strong against the headwinds facing the residential sector
- Our forecast is for relatively modest falls in the value of consented non-residential work of about 0.5-1% per annum for the next couple of years
- There is a strong pipeline of privately initiated projects in the non-residential sector which will support activity
- Almost 50% of the projects that are anticipated to start this year are office and retail projects
- Government projects, in particular in health and education, have represented ~33% of total consent approvals until recently, so spending announcements from government will be watched carefully

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Feedback

We trust that this report has provided some valuable insights. We will develop this resource over time, and warmly accept any feedback on the usefulness of information and opportunities to include other key drivers impacting our industry.

Don't hesitate to contact us at: matthew@eboss.co.nz or dom@eboss.co.nz

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