

THE PULSE

POWERING
STRATEGIC
BOARDROOM
DISCUSSION

INTRODUCTION

Welcome to Issue #3 of The Pulse (Q2 2023) — your quarterly degustation of local and global construction industry insights designed to power your boardroom strategic discussions and help plan for market demand.

WHAT'S INSIDE?

There are four key sections, all focused on understanding the demand for building materials across residential and commercial construction in New Zealand.

TODAY

—Where are we right now?

The latest data on code completion certificates (CCCs) issued & consented future building.

TOMORROW

—Where are we heading?

Residential and commercial construction forecasts.

HORIZON

—What can we learn from the rest of the world?

Global perspectives on construction activity and current and expected workloads in key regions; plus a freight and logistics summary.

CONSIDERATION

—Key future trends that influence product selection:

In-depth insights from a leading New Zealand building engineer — this quarter we interview Jonathan Hill of Kaizon.

HOW TO USE IT

We present a summary of key data, provide commentary and then share a thought starter to initiate debate and discussion around the opportunities or threats presented.

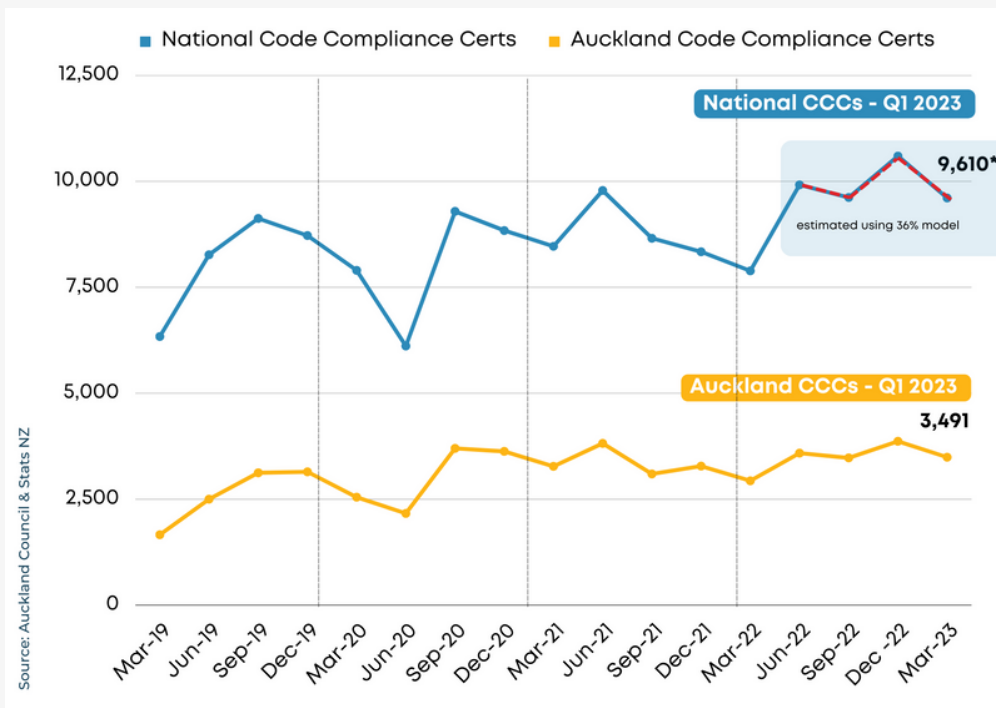
TODAY

Trends in completed and forecast (consented) residential builds (at March 2023)

Completed Building

Last Quarter (Jan-Mar '23)

- Auckland Council data shows Code Compliance Certificates (CCCs) fell back in the first quarter of 2023 to **3,491** (from the record level of 3,867 recorded in the final quarter of 2022)
- Nationally, we estimate **9,610** residential dwellings were completed in the first quarter of 2023 based on Auckland Council CCCs continuing to make up 36% of national completions
- And applying the same 36% model - we estimate a total of **39,750** dwellings were built in the 12 months ending Mar '23 - 5,076 more dwellings when compared to the previous period, supported by the growth in higher density developments



Consented Future Building

Last Quarter (Jan-Mar '23)

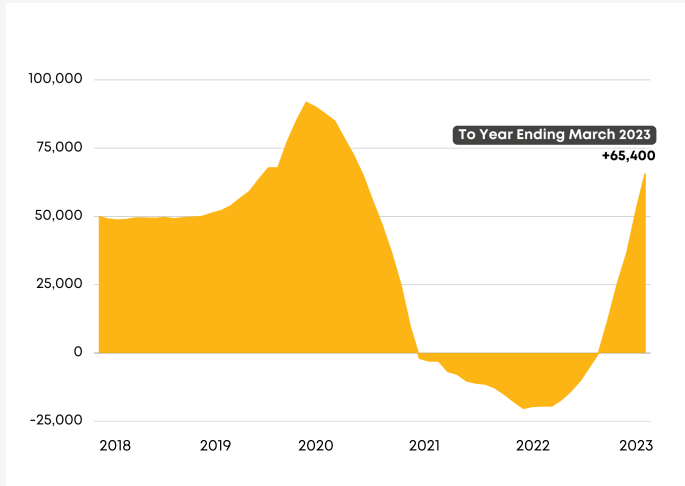
- Nationally, for year ending Mar '23, total consents have declined by 8% to 46,924 (from 50,964 in the previous period)
- We estimate that we're completing slightly fewer dwellings nationally than we are consenting — 9,610 vs 9,719 in the last quarter to Mar '23
- Nationally, 60% of all consents are now for attached dwellings
- And we're consenting 30% fewer stand-alone homes than we did in the Q1 2022



Other numbers we're keeping an eye on

Net Migration New Zealand







rolling year ended May 2018 - March 2023



Source: Stats NZ

- Net migration to year ending Mar '23 saw a gain of 65,400
 - These latest figures are the highest since the pandemic, which saw inbound flows peak in 2020
 - Coupled with a natural population growth of 18,600, the 12 months to March saw net population grow by 84,000 to 5.2m
 - Returning NZ citizens and migrants from India, China, Philippines make up over 50%
-
- RBNZ estimates 2 years to convert from renter to homeowner
 - Analysis by Forsyth Barr estimates 36,000 new dwellings will be required to meet a population growth of 84,000

General Economic Drivers (12 months to Mar '23, and comparison to Dec'22)

Unemployment Rate	Consumer Price Index (CPI)	Wage Cost Inflation
<p>3.4%  0.0%</p> 	<p>+6.7%  -0.5%</p> 	<p>+4.3%  +0.2%</p> 
Source: Stats NZ	Source: Stats NZ	Source: Stats NZ

- The latest ANZ Business Outlook Survey (May '23) concludes business confidence lifted in most sectors, including construction in May, and that inflation indicators generally eased
- RBNZ remains concerned about wage inflation, and further increases in wages are expected
- The RBNZ perceives widespread 'sogginess' across the economy, making them more relaxed about the extra stimulus being provided by net migration and more fiscal spending this year than anticipated. ANZ isn't so sure. Most of their activity indicators are well off their lows and rising, while cost and price indicators are inching lower, rather than plunging. Even the most interest-rate-sensitive sector, construction, is much less downbeat than previously
- ANZ expect that the RBNZ will be back at the OCR hiking table by the end of the year

THOUGHT STARTER:

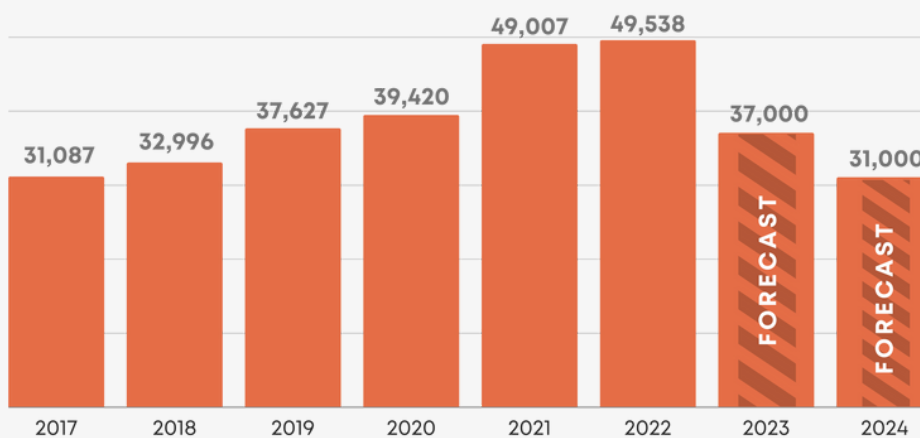
If net migration was to remain strong, developers should be thinking about locations in demand for accommodation and community facilities.

TOMORROW

Residential construction forecast

In the last few weeks two industry bodies have revised their residential building consent forecasts to **37,000** new builds for 2023. For one forecast this was a revision of 10% within a 3-month timeframe, which in itself speaks to how quickly this correction from record highs is happening.

BRANZ Annual Residential Dwelling Consents Forecast



- BRANZ forecast for 2024 predicts further easing, with residential new builds losing another 16% to 31,000 consents
- For perspective, the forecast 2024 number is back at 2017/2018 levels - could we conclude the recent highs will be seen in future as a 'Covid Blip' as we now adjust to the normality of a longer term trend?

Understanding Future Residential Demand

- RBNZ's May '23 Mortgage Lending figures (see chart overleaf) saw an increase of 35% or \$1.5bn on April's numbers to reach \$5.86bn for the month
- Pull back to rolling 3-month figures - overall lending continues upwards in 2023:
 - \$16.2bn for the three months Mar to May '23, compared to \$14.2bn for the previous three months
 - This latest 3-month rolling number is level with 3-month numbers in the latter half of 2022, despite significant OCR increases
 - In percentage terms, lending was up 14%, with First Home Buyers (FHBs) up 20% and existing homeowners up by 12%
 - Looking year on year however, mortgage lending is ~80% of 2022 levels and ~60% of 2021 levels

THOUGHT STARTER:

Government has positioned Kiwibuild to assist developers initiating residential projects in a soft market. What role can banks play in addressing affordability for FHBs?



New Residential Mortgage Lending by Borrower Type

	Previous years:			Monthly:			
	May 2021	May 2022	Jan 2023	Feb 2023	Mar 2023	Apr 2023	May 2023
Total lending (\$million)							
All borrower types	8,921	6,818	2,775	3,836	6,036	4,330	5,859
First home buyers	1,757	1,314	640	815	1,245	1,049	1,422
Other owner-occupiers	5,527	4,238	1,667	2,329	3,637	2,494	3,362
Investors	1,540	1,192	428	626	1,066	718	990
Business purposes	98	74	39	65	87	69	85

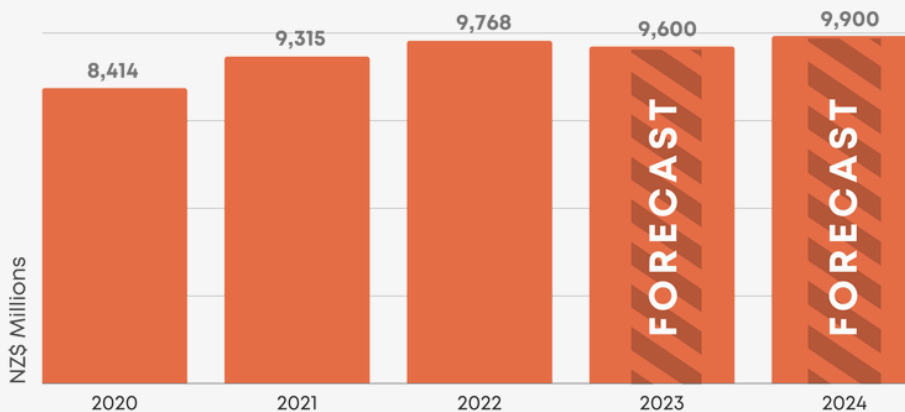
Source: Reserve Bank of New Zealand

- The latest OCR hike to 5.5% (24 May) continues to apply pressure to mortgaged households - especially when we remember the May-22 cash rate was merely 2%
- And 40% of mortgages are set to be refinanced in the next 3 to 12 months, totalling \$130bn
- FHB lending in May, as a proportion of total lending, saw a new record set at 24.3%
- FHBs typically account for 25% of all new townhouses, flats & apartments sales, which now make up 55% of all building consent approvals - this segment seems crucial to keep an eye on

Commercial construction forecast

- Thanks to a strong pipeline of education and health projects from government, commercial construction is forecast to remain healthy
- Industrial activity currently represents approximately 30% of consented construction value in a continued response to bolstering domestic production and storage
- Recent forecasts consistently predict commercial construction to stay at record levels for the foreseeable future at about \$10bn per year

BRANZ Annual Commercial Consent Value Forecast



THOUGHT STARTER:

Non-residential construction has been bolstered by infrastructure spending by the Labour Government ... with a change of party possible in Q4, how might this effect forecasts for 2025 and beyond?

HORIZON

Global perspectives on current and expected construction activity

To provide an idea of the demand and availability of building materials and resources outside of NZ, we have summarised the latest 2023 Q1 RICS Global Construction Monitor. Globally, 3,450 construction companies were surveyed, comparing conditions over the last three months and providing an outlook for the next 12 months.

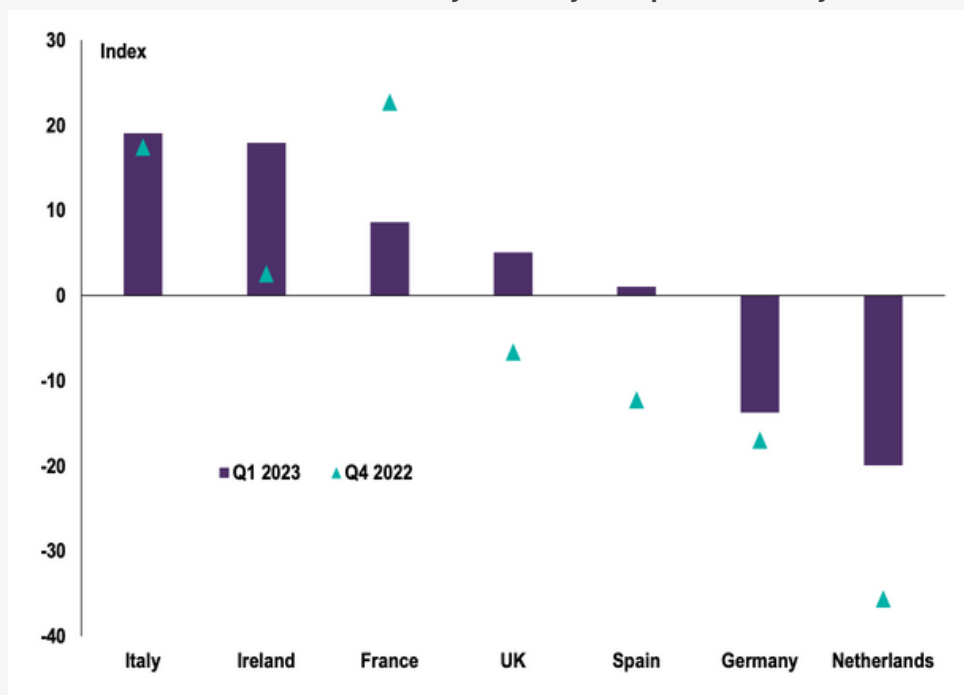
Overview

- APAC region saw the strongest quarterly pick-up, with improving conditions in China and India
- By way of contrast, Europe remains the weakest region pulled down by Germany and the Netherlands, with most other large economies broadly flat
- Growth in infrastructure workloads continues to outstrip residential and commercial in all regions
- Although material costs remain the most significant impediment to market activity, the latest feedback points to a slight easing of this pressure

Europe

- Construction demand in Europe is currently experiencing a general decline. Comparing conditions over the last two quarters, Italy and Ireland show some resilience, Spain, the UK and France have a declining outlook while Germany and the Netherlands are struggling

Construction Activity Index by European Country



Source: Royal Institution of Chartered Surveyors

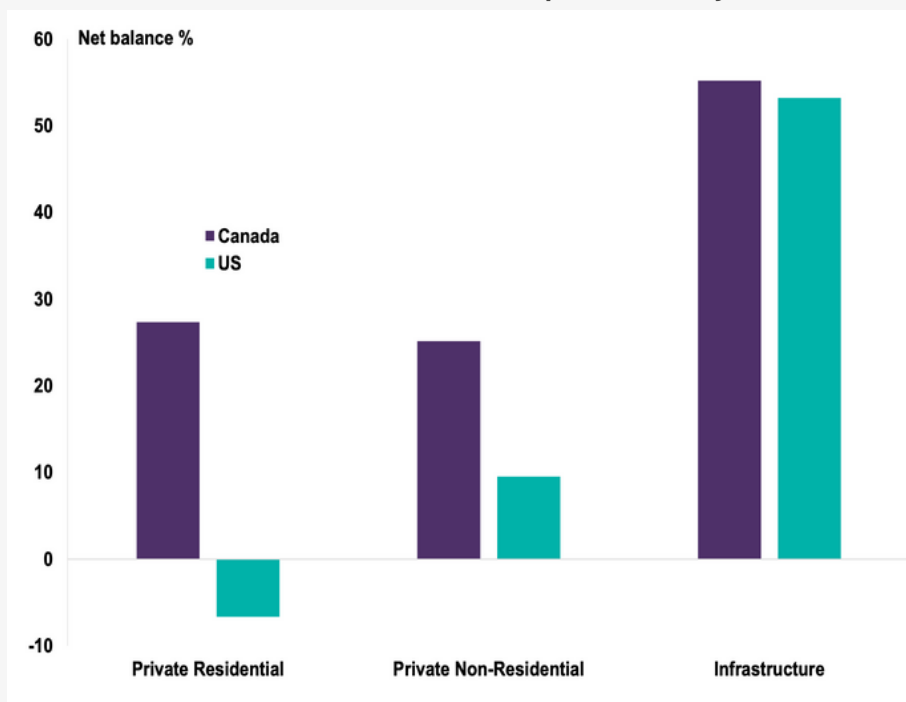


- The decrease in residential construction is primarily driven by rising mortgage rates
- In general commercial construction is stable, led by the UK, France & Spain
- Along with energy prices and cost of materials, in Germany, increased environmental legislation is referenced as a key local contributor to the decrease in demand
- Dutch government legislation focussed on halving Nitrogen emissions by 2030 is sighted as a key issue for Dutch construction, with the building industry as the 3rd highest contributor to Nitrogen emissions in The Netherlands
- European contractors are experiencing low margins, and expectations suggest further tightening due to high inflation and softening demand

Americas

- Further tightening by the Federal Reserve and the Bank of Canada is leading to high-interest rates and more restrictive lending conditions, increasing negative sentiment across residential and commercial construction markets
- The outlook for US residential construction is for it to retract further over the next 12 months, with commercial construction flat. Keep an eye on the US unemployment rate, which is projected to rise from 3.5% in March to a high of 4.6% in 2025 (Source: DHL OFR May '23 Report)

Americas 12-month Workload Expectations by Sector



Source: Royal Institution of Chartered Surveyors

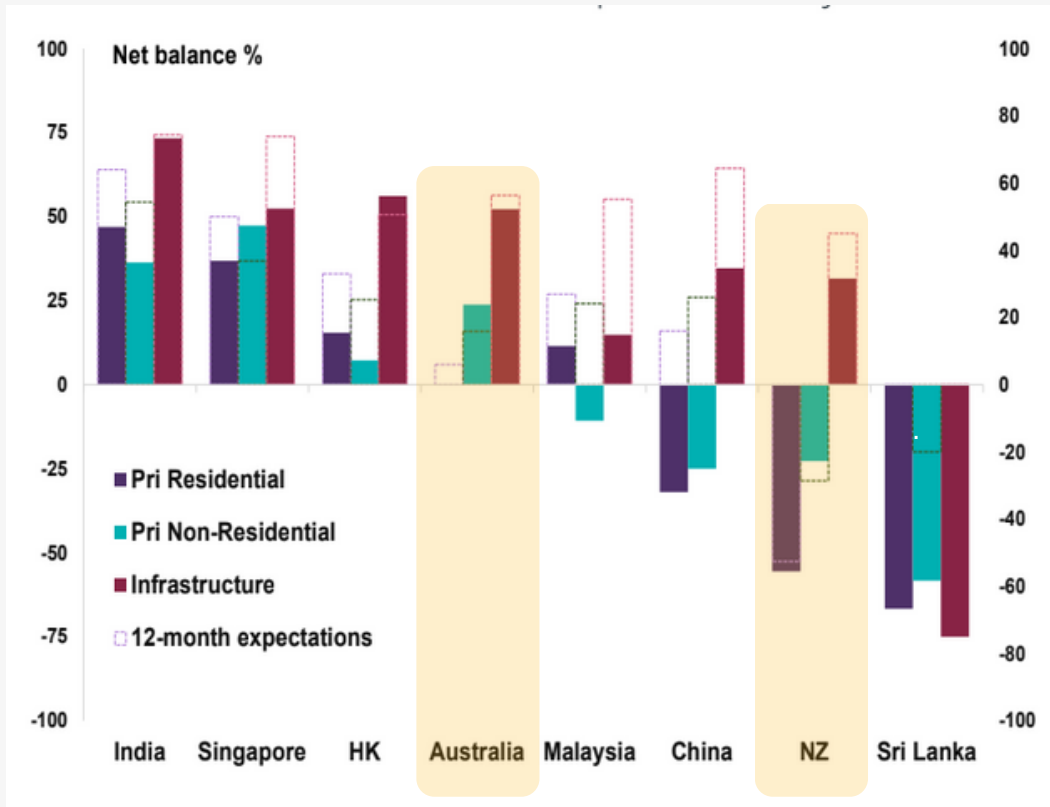
- The outlook for Canadian construction is much stronger; however comments suggest that demand is weakening
- The profitability of main contractors is also a concern, with increases in labour and operating costs exceeding softening material prices
- There is a large and growing commitment to infrastructure investment, as there is in most regions currently



APAC

- The APAC region has the highest level of construction growth due to significant infrastructure investment
- China is expected to experience growth in residential and commercial construction following the lifting of three years of zero-COVID policies
- Chinese policies to ease credit conditions for property developers have sparked recoveries in housing prices, sales and construction completions; however, new housing starts are historically weak
- India's growth is also ongoing, but there are concerns about the increasing costs of building materials and their impact on future projects
- Meanwhile, across the ditch, although construction is expected to soften in Australia, growth in residential construction and stabilising in commercial construction puts it in a strengthened position over the next 12 months relative to our local market

APAC Current Workloads & 12-month Expectations by Sector



Source: Royal Institution of Chartered Surveyors

THOUGHT STARTER:

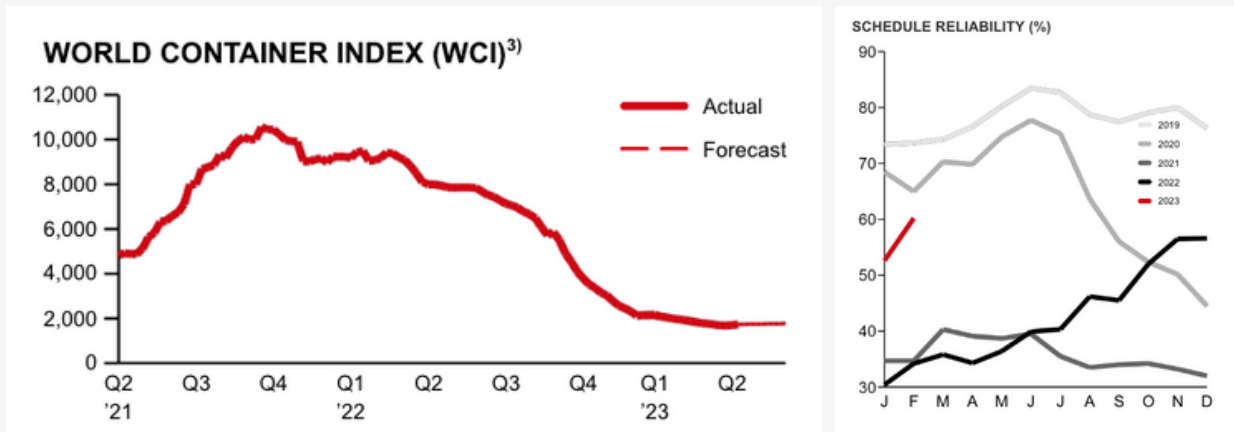
How can we use softening demand globally to the best of our advantage for future projects here? We should be considering addressing the environmental impacts of construction, to ensure we are prepared for the changes now impacting key European countries.

Global freight and logistics summary

From the recent DHL Air & Ocean Freight Market Reports (April & May 2023 respectively), we can review the effect of logistics for suppliers of building materials which has a large impact on the cost and availability of materials.

Current Outlook - Ocean Freight

- The World Container Index reports that the US\$ spot rates for 40-ft containers are currently at low levels and are projected to remain stable. The cost of freight destined for the South Pacific out of Europe is expected to improve, while container rates from the US will stabilise
- In February, Global Schedule Reliability increased by 7.7 percentage points to reach 60.2%. Year on year, reliability has increased by a significant 26 percentage points
- As a result of the steep drop in freight rates, Shipping companies COSCO & Transpacific have had a significant decline in profits of 60-75% in Q1 2023
- Key ports are expanding, and new ships are launching to meet future demand. Rotterdam, for example, plans to add capacity for an additional 2 million containers annually



Source: DHL Ocean Freight Market Report (May '23)

Current Outlook - Air Freight

- Capacity remains sufficient considering the currently low volumes
- Spot rates are competitive across most trade-lanes, with slight increase in charter rates
- Jet fuel prices remain higher than normal with OPEC cutting production for liquid fuels

Commentary from Zane Morton, Managing Director, DHL New Zealand

"Auckland ports have commenced resuming port berth slots in an effort to bring schedule reliability back to the market, which is starting to have a positive impact and the utilisation at the ports (yard space) is much more manageable (65 – 75% utilised) which means flows of containers on and off the port are more effective."

THOUGHT STARTER:

With international freight becoming increasingly efficient, what will this mean for suppliers that have transferred from a "just in time" to a "just in case" approach? Will this mean smaller warehouses and stock holdings domestically?

CONSIDERATION

Strategic insights from Jonathan Hill



Te Ao Nui, Palmerston North

This month we speak with **Jonathan Hill, Director of Kaizon Engineering** — a full service building envelope engineering company with a focus on leading the industry in delivering tailored solutions through collaboration, knowledge, and education.

As Director, Jonathan oversees operations and strategic planning, while also bringing his extensive engineering expertise to the technical elements of the firm's larger and higher risk projects. Having gained experience in North America, Europe and South America, Jonathan is committed to further advancing the industry here in New Zealand.

What do you think is working well within NZ's design and construction industry?

We've made strides over the last 5 to 10 years as an industry. There are a lot of smart and creative people focused on increasing performance and durability, and using innovative design and construction methods like modular building. And at the same time, minimum code compliance is being raised and we're advancing our standardised best practices.

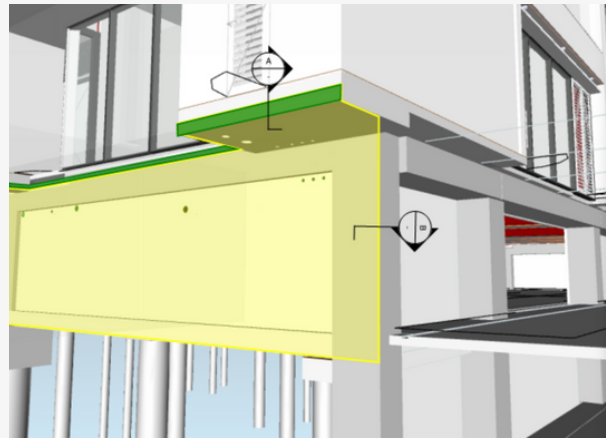
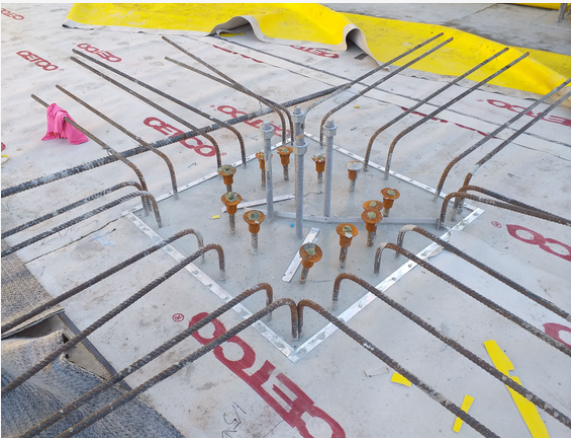
A lot of stuff that's still relatively new here is popping up more regularly on projects — you now have a warm roof, you now have a true rain screen with an underlay, and we're looking at condensation. And there's also this underlying desire for the industry to continue to learn and design and build better.

And what isn't working well?

The consenting process — the reliance on consents and the time it takes to get a consent. It's challenging as how the Building Act is set up means that the BCAs are ultimately responsible for compliance. This tends to lead to confusion on project teams as to who's responsible for what. For example, are councils qualified to be reviewing façade details?

Or should they be able to rely on industry experts? We really need a better understanding of the consenting process and responsibilities of both the designers and the consenting authorities.

And we still tend to default on just getting consent so work can go out — and that's ultimately achieving minimum compliance rather than focussing on what's best for the project and end users. We all know these buildings that are leaking and failing were deemed compliant. So if we're still using that as our minimum bar, when push comes to shove, we still default to that low standard.



10 Madden Street, Wynyard Quarter, Auckland

What opportunities are there for the industry to innovate and improve?

It comes down to challenging ourselves and educating ourselves using all resources available. If there's a new solution coming out, we need to research that by not just looking for feedback in New Zealand, but looking internationally because we can learn from others. We can get more access to international resources and tools, and even conferences in this virtual world we live in now. We need this education and information to push the industry, and in a country of just over five million it's hard to self generate that.

Then there's the big ticket stuff like futureproofing, climate change, energy efficiency, healthier buildings and carbon reduction — all of these things are coming from government-driven incentives ... but should be industry goals as well. If we're just stuck on delivering buildings compliant with today's codes, we'll get lost because we know those requirements will be changing. So we need to be really focussing on the big picture and designing for the future.

What's the single biggest challenge the industry will face during the next 5 years?

Cost is having the biggest impact right now. Controlling costs or getting accurate depictions of costs is important — and that's product costs and material costs, but also consultant costs and all of those things. We have all these innovative projects with innovative solutions, but to actually deliver these projects, the costs need to be reigned in or we need to at least understand what those are.



Access to skilled people is another big challenge — both the development of young people within New Zealand, and bringing in experts from overseas and retaining them. Post-Covid the younger generation in New Zealand want to get out and travel more, while newer immigrants often leave after 3-5 years. How can we keep up-and-coming people in the industry from taking all this knowledge and leaving?

What do you think suppliers need to focus on to better support the industry?

If they're bringing something in from an international manufacturer, they need to understand how that product or system works, how it was initially designed and intended to be used, and what happens if they make changes to the system. Where an element of a system is switched out — for example for a product more readily available here in New Zealand — the supplier needs to make sure they have manufacturer's approvals and have got the supporting testing that shows that it will perform the same way as intended.

Communication could also be improved. Suppliers want us, as designers, to talk to them before we design and specify their product so they're comfortable with how it's being used. On our end we want them to contact us before telling a contractor or installer that a detail change or installation method is fine — as it might not be fine from our standpoint. It's that kind of communication flow that needs to be done better.

THOUGHT STARTER:

With increased complexity in the design of our buildings, we need to ensure that we build and retain knowledge locally. How, as an industry, can we improve the development and retention of key people in our teams?

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