Q3 2023

ISSUE #4

THE PULSE

POWERING STRATEGIC BOARDROOM DISCUSSION

EBOSS

INTRODUCTION

Welcome to Issue #4 of The Pulse (Q3 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.

CONSIDERATION

— Q3 Supply Chain Update, plus Matt Curtis (BRANZ) interview

Summary of our 6th Supply Chain survey, and BRANZ economist explains latest model to estimate national CCCs.

HOW TO USE IT

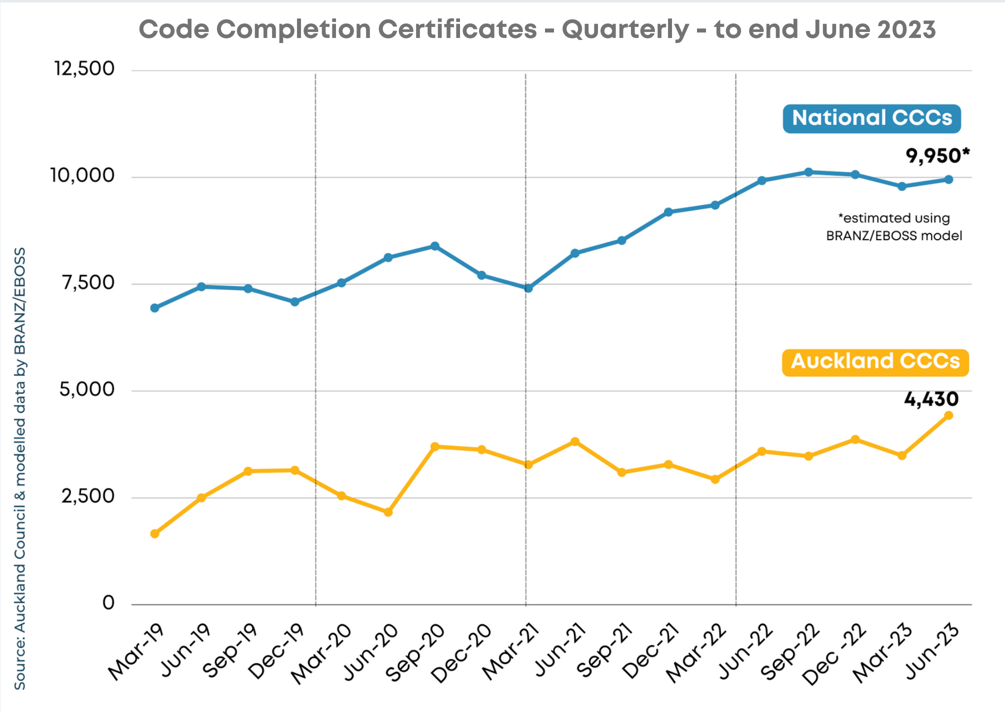
We present a summary of key data, provide commentary and then share a thought starter to initiate debate and discussion around the opportunities or threats presented.

TODAY

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

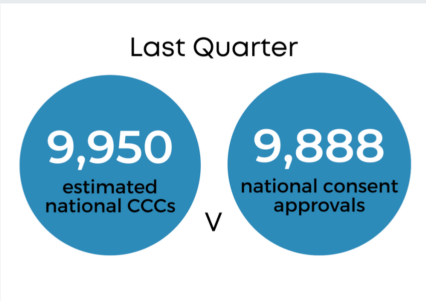
Completed Building
Last Quarter (Apr-Jun '23)

- In the continued absence of national Code Compliance Certificates data from Stats NZ, we've further refined our estimation model (used in previous Pulse reports) with expertise from Matt Curtis, BRANZ Economist
- Using the new model*, we estimate **9,950** residential dwellings were completed nationally in the second quarter of 2023 contributing to a rolling 12-month completion number of **39,930**
- That represents **2,942 more homes** completed than the previous year (+8%)
- Auckland Council data shows CCCs jumped in the second quarter of 2023 to reach 4,430 for that quarter ending June - the highest completion rate on record



Consented Future Building
Last Quarter (Apr-Jun '23)

- Nationally, for the year ended Jun '23, total consent approvals have declined further to sit at **44,529** (50,736 for year ended Jun '22)
- We estimate we are now completing slightly more dwellings nationally than we are consenting — 9,950 vs 9,888 in the last quarter to Jun '23
- Nationally, 59% of all new consents are now for townhouses, flats and apartments



*Understand the new model in more depth - read our interview with Matt Curtis on page 10

Other numbers we're keeping an eye on

General Economic Drivers (12 months to June '23, and comparison to March '23)

Unemployment Rate

3.6% (+0.2%)

Source: Stats NZ

Consumer Price Index (CPI)

+6.0% (-0.7%)

Source: Stats NZ

Wage Cost Inflation

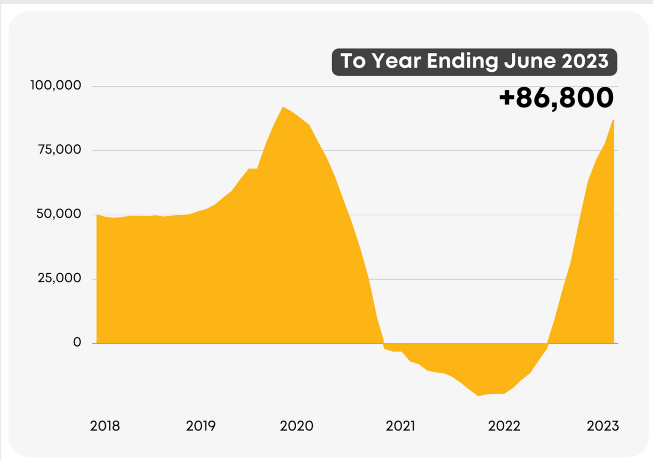
+4.3% (0.0%)

Source: Stats NZ

- From a historical perspective, unemployment remains low, albeit creeping ever so slightly higher. Inflation has fallen, fuelling confidence the RBNZ will leave the OCR alone for now. And wage inflation remains unchanged in the last quarter too
- The latest ANZ Business Outlook Survey (Aug '23) presents the 'least bad' result since the middle of 2021, with many firms pleasantly surprised by how demand has held up
- Of those sectors surveyed by ANZ, construction firms 'have taken real heart from the turnaround in the housing market', with net positive sentiment rebounding encouragingly
- Tony Alexander's continued view is we are simply experiencing 'a correction', not a slump. Tony's surveys since the beginning of 2023 have seen residential construction expectations shift to a net 7% pessimistic, up from 24% in July, 52% in June and a gloomy 84% net pessimistic in February
- Net migration continues to be strong, driving rent rises in the short term, but promising future build demand.

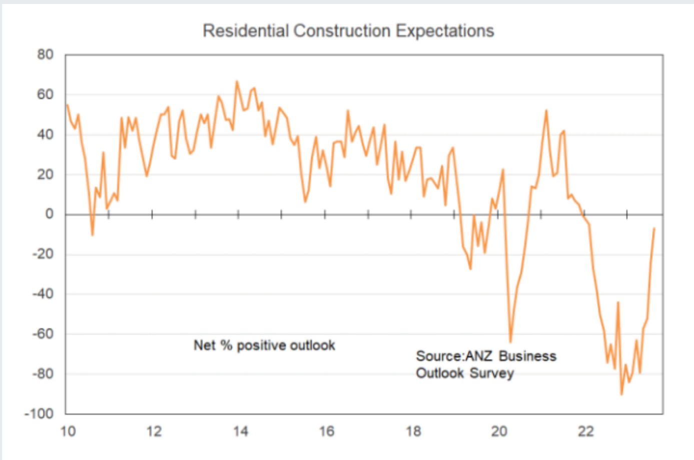
Net Migration New Zealand

Rolling year ended May '18 - June '23 - Stats NZ



ANZ Business Outlook Survey - Aug '23

Residential Construction Expectations - Net % positive outlook



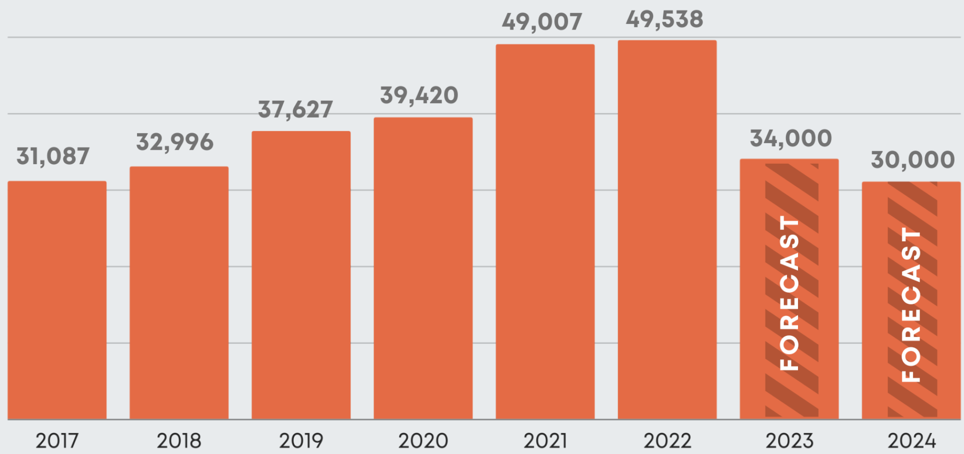
THOUGHT STARTER: How will the new Accredited Employer Work Visa settings (effective Dec '23) impact the demand for housing?

TOMORROW

Residential construction forecast

BRANZ has continued to revise their residential building consents downwards for 2023 and 2024. "Affordability is playing a key role in putting a handbrake on residential construction consents," explains Matt Curtis, BRANZ Economist, "the increases in the official cash rate over the last year and then construction cost inflation have made lending and pre-sales difficult to obtain."

BRANZ Annual Residential Dwelling Consents Forecast



- Matt does add that there are indeed green shoots ... with strong net migration, Kāinga Ora's work programme and the disaster recovery work
- Nationally architect workloads have dropped with many urban clients pausing projects till after the election

Understanding Future Residential Demand

- The latest RBNZ Mortgage Lending figures (**see chart overleaf**) saw total lending fall back by 10% in September, from a strong August, to settle at almost $5.2bn
- Turning to the **rolling 3-month figures** for a trend perspective - overall lending remains positive given the sustained high OCR level:
    - Just under $16bn for the period July to Sept '23
    - Which perhaps surprisingly is level with 3-month numbers seen in the same period in 2022
    - By lending type: First Home Buyer (FHB) lending eased 2.5% and Other Owner Occupiers by 3%
- **Total lending for the last 12 months** to September '23, was $61.25bn versus $76.96bn for the previous period
- From a macro view, mortgage lending is still ~80% of 2022 levels and ~60% of 2021 levels

New Residential Mortgage Lending by Borrower Type

	Previous years:		Monthly:				
	Sep 2021	Sep 2022	May 2023	Jun 2023	Jul 2023	Aug 2023	Sep 2023
Total lending ($million)							
All borrower types	6,934	5,135	5,859	5,686	4,997	5,782	**5,194**
First home buyers	1,173	1,064	1,422	1,385	1,238	1,368	**1,253**
Other owner-occupiers	4,453	3,207	3,362	3,288	2,842	3,340	**2,965**
Investors	1,232	809	990	939	854	986	**894**
Business purposes	77	55	85	74	64	88	**82**

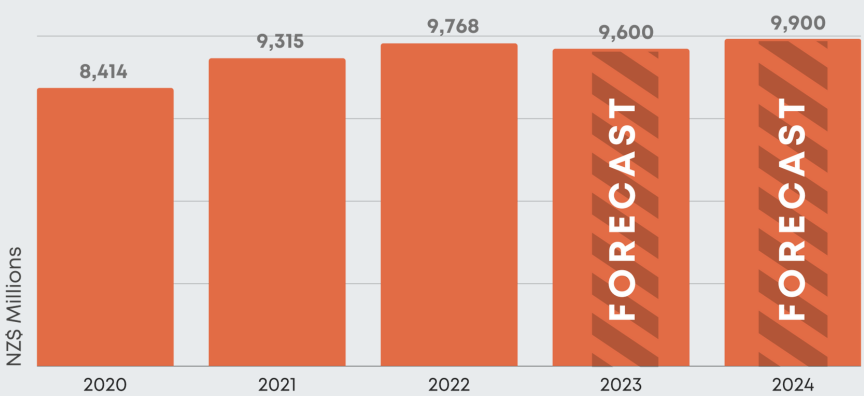
Source: Reserve Bank of New Zealand

- The **OCR** remains at **5.5%** - no change since May, but banks are applying a stress test rate of nearly 9%
- As a proportion of total lending, FHB lending for June to August remains in record territory **of over 24%**
- FHBs typically account for 25% of all new townhouses, flats and apartments sales, which now make up **59% of all building consent approvals** - this segment remains crucial to keep an eye on
- The proportion of lending to Other Owner Occupiers continues to hug a 2 year low of 57%
- There are reports of investors back in the auction rooms, and data is beginning to support that

Commercial construction forecast

- Commercial construction may be hampered slightly by the upcoming election, but forward workloads continue to look strong with plenty of projects in the pipeline
- Total consents value for the year to July '23 topped $10 billion for the first time and forecasts consistently predict commercial construction to stay at record levels for the foreseeable future
- The New Zealand Infrastructure Commission Te Waihanga reports a solid pipeline of infrastructure construction for the coming years, particularly in transport ($18bn)and water projects ($41bn).

BRANZ Annual Commercial Consent Value Forecast



THOUGHT STARTER: How can we help architects reinvigorate recently stalled projects and increase design work in their pipeline?

HORIZON

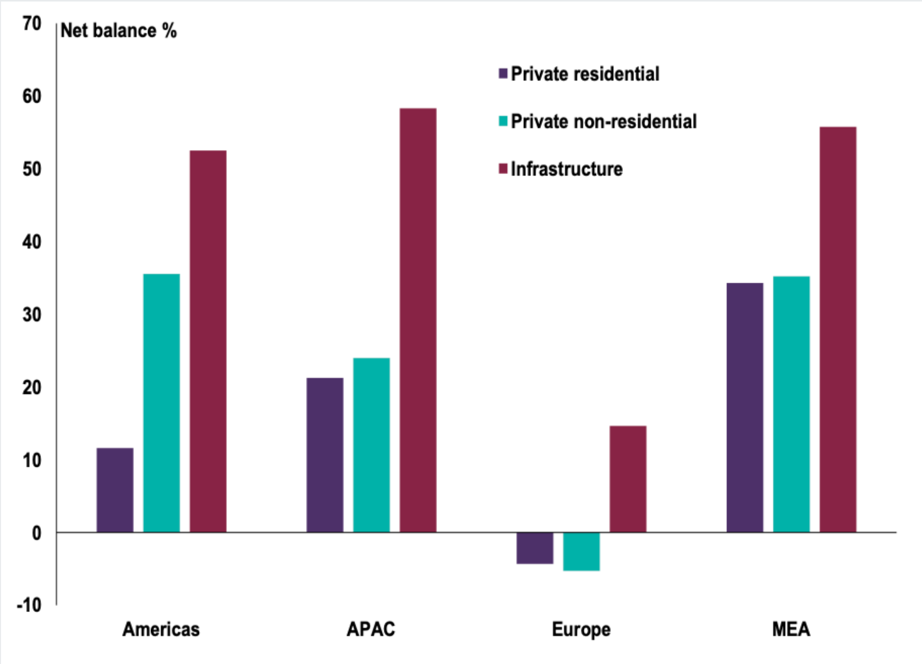
Global perspectives on current and expected construction activity

To provide an idea of the demand and availability of building materials and resources outside of NZ, we have summarised the latest 2023 Q2 RICS Global Construction Monitor. Globally, 2879 construction companies were surveyed, comparing conditions over the last three months and providing an outlook for the next 12 months.

Overview

- The Middle East, Africa and India continue to see strong growth, with the Americas going into expansion territory in Q2
- By contrast, growth in Europe remains at week levels
- **Infrastructure** continues to expand across most nations globally, while feedback is more varied on residential and non-residential activity
- Material costs and access to finance is of concern, with most seeing tightening in lending conditions as global economies battle inflation
- Globally construction costs are forecast to rise by 5% over the next 12 month, mainly driven by ongoing shortages of skilled labour
- Other factors considered to be hindering the sector include financial constraints, skills shortages and labour shortages, with close to two-thirds of respondents pointing to each of these issues as market impediments in Q2

12 month Global Construction Workload Expectations by Sector

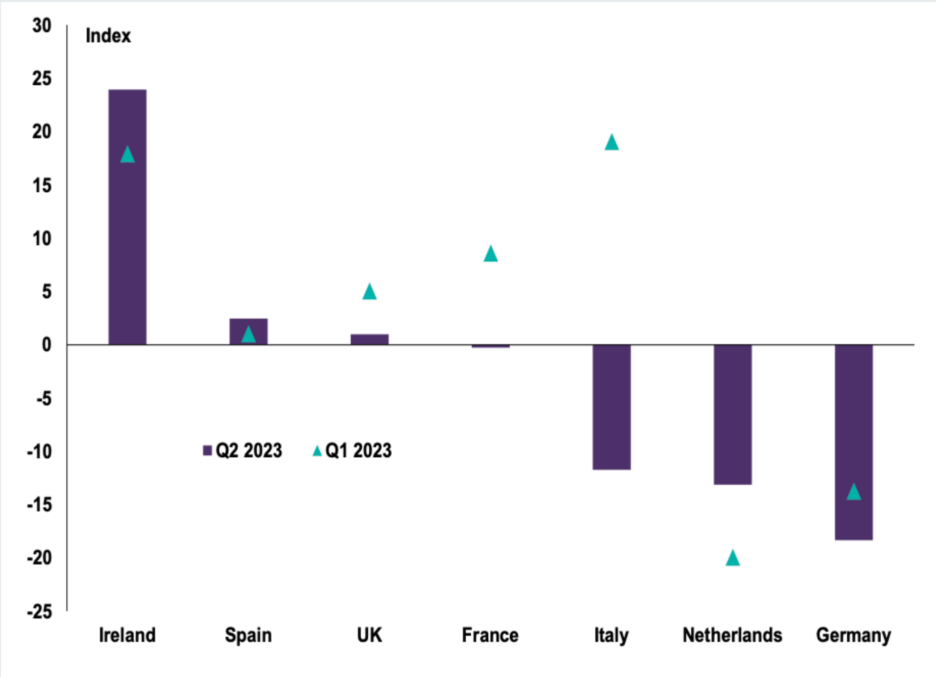


Source: Royal Institution of Chartered Surveyors

Europe

- Activity has remained flat across three consecutive quarters, although some regions are performing better than others. Feedback from Germany, the Netherlands and Italy shows a contraction in activity, with a sluggish outlook in France, the UK and Spain
- In contrast, sentiment in Ireland was largely positive and a bright spot on the map
- The rise in interest rates is continuing to dampen demand of residential builds
- In general, workloads are falling significantly across the residential sector, while the commercial sector trends stagnant at best

Construction Activity Index by European Country



Source: Royal Institution of Chartered Surveyors

North America

- Despite further tightening by the Federal Reserve and the Bank of Canada, construction activity remains resilient in the face of higher interest rates and more restrictive lending conditions
- Alongside other nations, the pipeline for infrastructure is positive, with a **3 percent rise** in the US and **8 percent rise** in Canada
- The outlook for residential construction also improved with a **13 percent** and **10 percent** rise in the respective countries above
- In commercial construction, offices and retail remain the most challenged
- Participants report **labour** and **skilled staff** as two important areas which remain challenging, compared to financial constraints reported in Q1

Middle East and Africa

- Sentiment has remain unchanged in Q2, with the region reporting the strongest sentiment across all regions
- Looking closer, some countries report stronger activity than others, with Saudi Arabia and UAE remaining stable, compared to a slight dip in Nigeria and Egypt

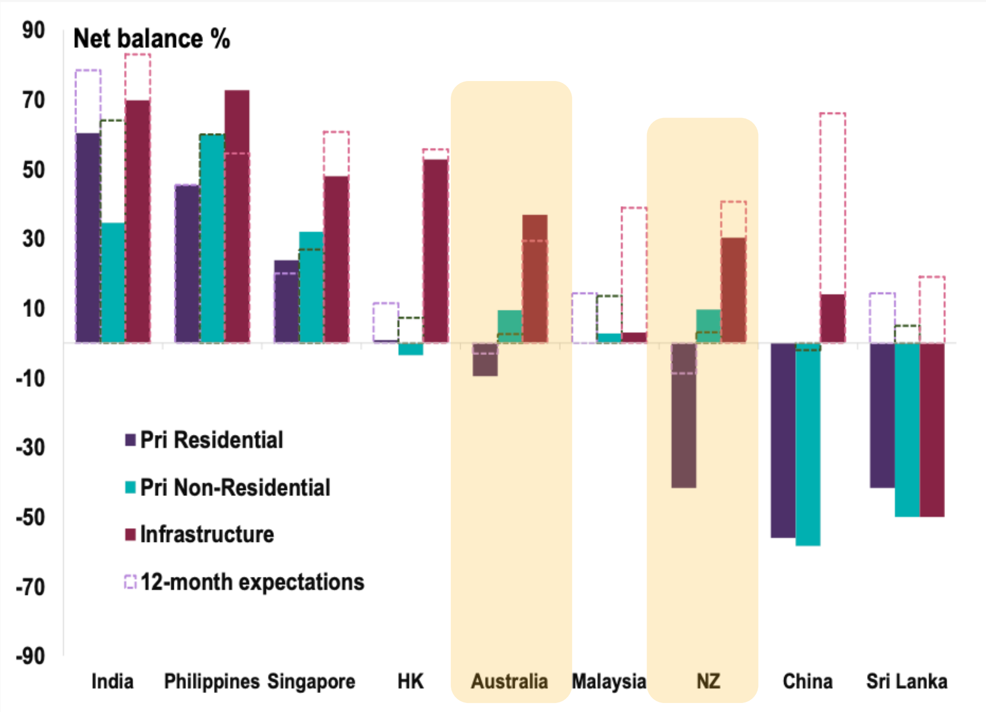
APAC

- Feedback from the Q2 report suggests **a slight loss of momentum** seen in the previous reports, however, sentiment is mixed at a country level
- Singapore remains fairly robust, with readings for Australia, Hong Kong and Malaysia trending only modestly positive
- India and the Philippines show the strongest levels of forward work in all categories
- In China, expectations of growth in both residential and commercial construction, following the lifting of COVID restrictions, have not materialised. This is reflected in weaker forward levels of work and a recent downgrading of economic growth forecasts
- On a more positive note, participants report **lower cost pressures** for the first time since **Q2 2022**, suggesting inflationary pressures are easing

Construction Activity Index by APAC Country

Source: Royal Institution of Chartered Surveyors

APAC Current Workloads & 12-month Expectations by Sector



Source: Royal Institution of Chartered Surveyors

THOUGHT STARTER: Key markets globally still reflect weaker residential demand which should position NZ in a stronger position when negotiating supply agreements.

CONSIDERATION - PART I

Modelled CCC data with Matt Curtis

This month we interview **Matt Curtis, BRANZ Economist** to learn more about the inputs and assumptions used to model our latest estimation of national Code Completion Certificates (CCCs) which is presented in the TODAY (p.3) section of this report.

In previous Pulse reports, we used a simple '36% model' where we assumed Auckland completions represent ~36% of national completions. But as Matt explains there's the opportunity to include more inputs and expand the modelling computation.

What is the current status of official national completion data?

Currently, there is no official data release, although we are expecting Stats NZ to commence a regular release in 2024. However, Stats NZ did publish an experimental data set from Q1 2011 to Q1 2022, which remains available, and Auckland Council does publish its monthly CCC data. This Stats NZ experimental data set covers less than 2/3 of total new dwellings consented in New Zealand. So alongside national consents data, the primary predictor of completions, these sources do combine to provide a credible opportunity to model a more complete analysis to assist the industry in the absence of official data.

Why is it important to revise the model?

Better understanding of the relationship between consents issued and eventual completed builds is crucial for the industry to best predict workloads. We know that not all consents are converted to builds, and therefore, demand for materials and labour needs to be understood more from a lens of what is going to be built than what has been consented. It is also important to understand completions as we need to shift the narrative from building intentions to completions. We have a tendency to compare dwelling consents to population growth and assume that everything that we consent is going to be built. The Stats NZ experimental data set showed that completion levels may be significantly below what is being consented though, particularly as consent numbers reached record levels.

What are the key inputs and assumptions that contribute to the model?

Firstly, from experimental CCC data by Stats NZ we can assume detached homes typically take 9 months to complete from consent issuance, and attached dwellings 12 months. So this allows us to incorporate this lag effect and model our expected completions taking into account dwelling types. The second input is the typical completion percentage rate of consents issued. With the 11 years of Stats NZ experimental CCC data, we can see the rate is not consistent, in fact quite varied.

So today, how does the model suggest we're tracking for annual completions?

Using the new model, we now estimate 9,950 residential dwellings were completed nationally in the second quarter of 2023 contributing to a rolling 12-month completion number of 39,930. We think our 12-month rolling prediction model is accurate in identifying most of the variance, but we cannot easily include factors such as COVID-19 lockdowns or the subsequent catch-up in CCCs in the modelling.

CONSIDERATION - PART II

Q3 | 2023 Supply Chain Update

Over the last 2 years, EBOSS has produced 6 reports canvassing opinions from leading product suppliers to better understand the current and expected reality of the construction supply chain.

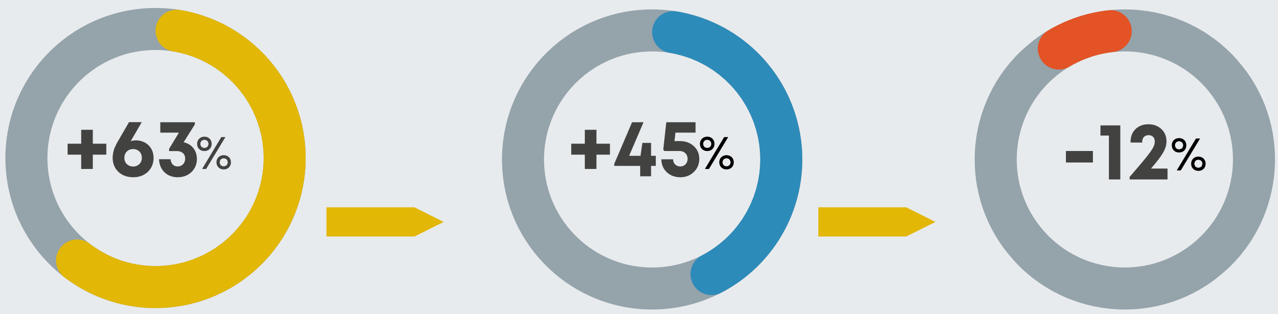
The data for this Q3 update was gathered in July 2023, with responses from managers of 170 leading product suppliers across all main product categories.

*NB: The ratings in some of the bar charts may not add to 100%. this is due to rounding.

Supply chain challenges have eased

- Our Q3 2023 Construction Supply Chain survey indicates a resolution of supply issues, with only one in five suppliers encountering market supply problems
- This marks a significant improvement from the peak of 81% reported in November 2021
- During the peak of these supply chain issues, suppliers bolstered their stock holdings to mitigate disruptions for customers
- However, this strategic move introduced cash flow vulnerabilities, compounded by rising buy-in costs not fully transferred to the market
- By mid-2023, the landscape has shifted. Suppliers have transitioned from a precautionary stock-holding approach to a "just-in-time" strategy, depleting stock levels due to improved freight accessibility and reduced demand

Net change in approach to stock holdings



Feb 2022 to July 2022 | **Aug 2022 to Jan 2023** | **Feb 2023 to July 2023**

*Net change = the percentage who increased their stock holdings, less the percentage who decreased

Cashflow concern persists for suppliers, with squeezed margins for those unable to fully pass on cost hikes to the market. Amid challenging conditions, differentiation from competitors is pivotal to thrive within a diminished demand landscape.

Moderated price increases

The pronounced buy-in and sell-at price surges of the past 18 months have decelerated. Roughly one in ten suppliers anticipates price decreases over the next year. Across all categories, emphasis now rests on price stability. Overall, considering those raising, maintaining, or lowering prices, a net projection of approximately a 1% price increment is envisioned over the next six months.

Cost you buy in at

+4% In the last 6 months

+1% In the next 6 months

Price you sell to market at

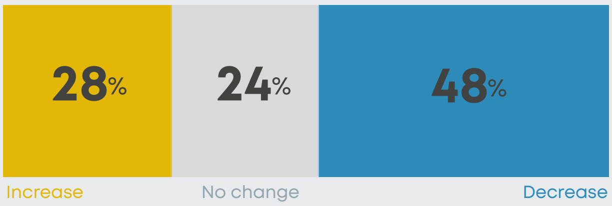
+1% In the last 6 months

+1% In the next 6 months

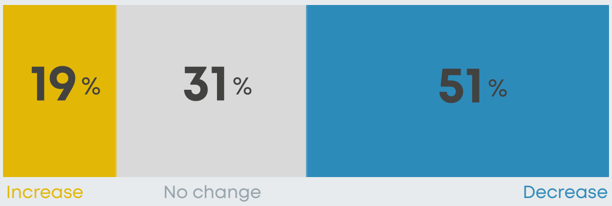
Diminished demand emerges as the subsequent hurdle for suppliers

- Following supply tribulations and margin strain, suppliers now confront subdued demand due to a slowdown in residential building consents. Those with higher-than-ideal stock levels face an especially intricate situation as conditions tighten
- In the last six months, 50% of suppliers experienced demand reduction, while the remaining 50% anticipate declining demand until year-end

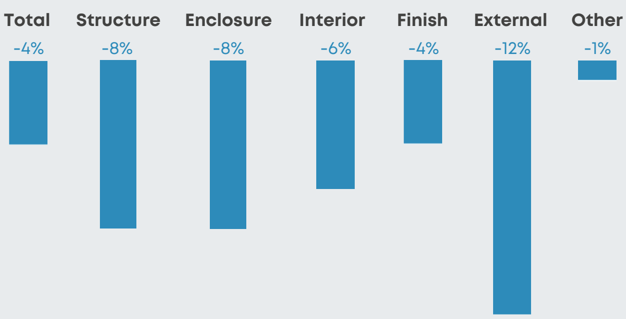
Change in demand
February to July 2023



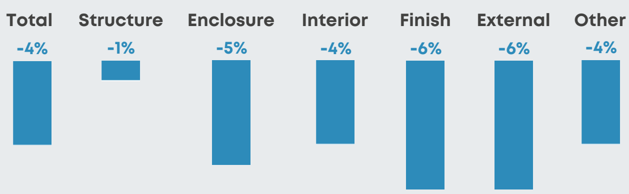
Expected change in demand
August 2023 to January 2024



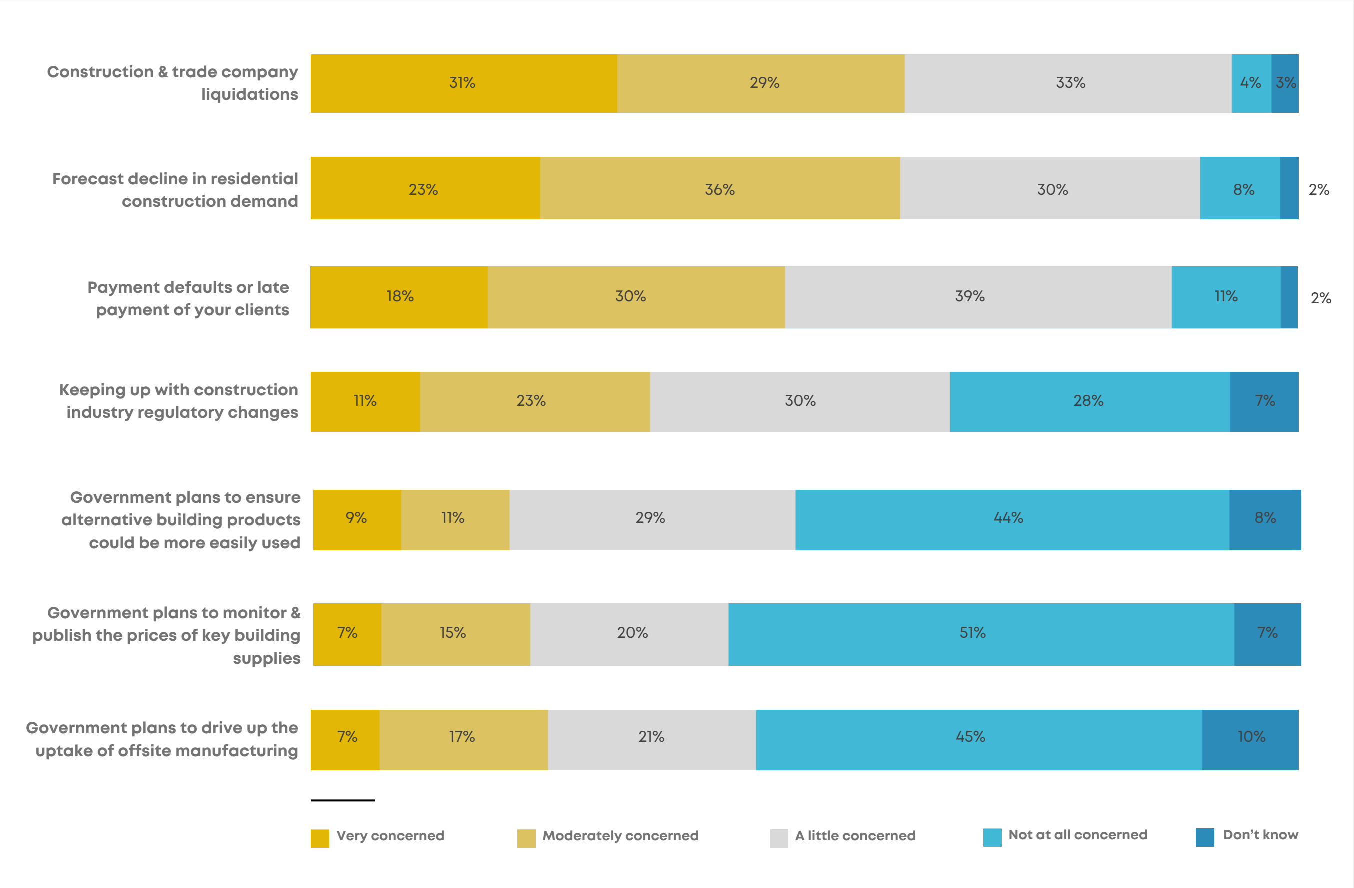
Average shift in demand
February to July 2023



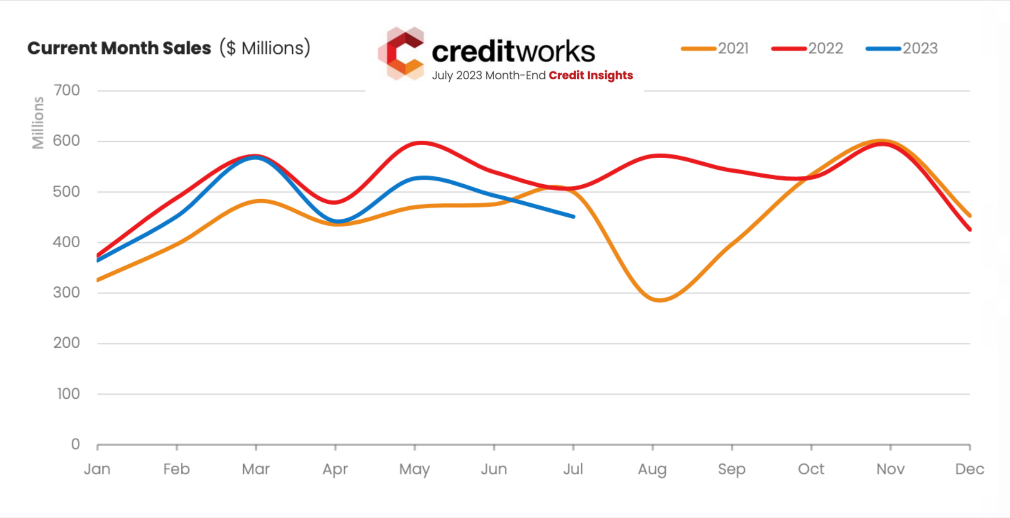
Average expected shift in demand
August 2023 to January 2024



Consequently, some suppliers are currently operating in survival mode, evident by their primary concerns in the chart below. While in a different year, government initiatives to facilitate substitutions or disclose pricing might have caused significant worry, they now take a backseat to apprehensions regarding trade liquidations and declining forecasts.



Building Merchant Current Month Sales ($ Millions)



Month-on-Month

8.5%

Monthly sales decreased by 8.5% from June 2023 to July 2023.

Year-on-Year

11.0%

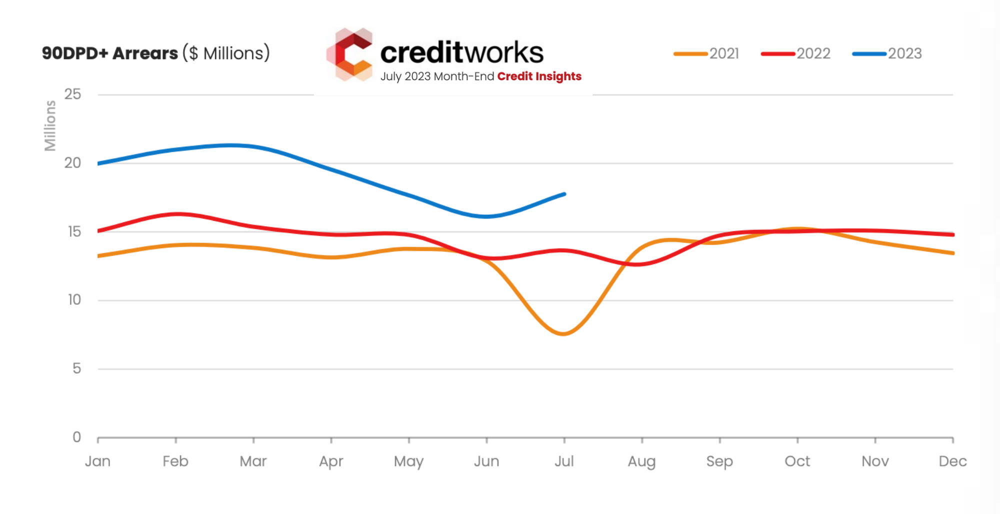
Monthly sales for July 2023 were 11.0% lower than July 2022.

Source: Creditworks July 2023 Month-End Credit Insights

Given the concerns regarding construction and trade company liquidations indicated in the Q3 Update above, we turned to **CreditWorks** to see if there was evidence of this beginning to show in data they collect from Building Merchants.

And indeed when you compare building merchant sales and the current level of debt past due 90 days (90DPD+) we have rising 90DPD+ against lower monthly sales. See charts above and below for detail.

Building Merchant Arrears in Dollars ($ Millions)



Month-on-Month

10.2%

90DPD+ arrears were up 10.2% from June 2023 to July 2023.

Year-on-Year

30.1%

90DPD+ arrears were up 30.1% from July 2022 to July 2023.

Source: Creditworks July 2023 Month-End Credit Insights

THOUGHT STARTER: Do your trade terms need to be reviewed in a market of tightening conditions?

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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