

ISSUE #5

THE PULSE

UNDERSTANDING FUTURE DEMAND
FOR RESIDENTIAL AND COMMERCIAL CONSTRUCTION



INTRODUCTION

———— Welcome to **Issue #5 of The Pulse** - your quarterly degustation of local and global insights designed to help you understand the future demand for residential and commercial construction.

We're excited to announce that this latest issue is the first of a new series of reports that combine insights and opinions from **EBOSS** and our expert partners:

- **BRANZ**
- **CreditWorks**
- **Forsyth Barr**

We'd also like to thank the **Ministry of Housing and Urban Development** for their 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

What you need to know in 60 seconds:

YESTERDAY

- Record levels of housing completions (CCCs), led by Auckland on the back of record 2021/22 consent approvals
- At an estimated annual 40,000 CCCs (Oct 2023), it appears only 80% of consent approvals are proceeding
- First Home Buyer lending at record levels as a proportion of total mortgage lending
- The gap narrows between cost to build and cost to buy ... as construction cost inflation eases and house prices start to rise

TODAY

- Evidence of strong monthly building merchant revenue for 2023, only 7-12% down this year compared to the record levels of 2021/22
- Nov 2023 building merchant monthly sales strong at over \$500m, evidence of a seasonal spring leap
- Timing of construction-related revenue suggests the current lag from consent approval to construction starting is 7 months

TOMORROW

- October's national consent approvals set to achieve 39,000 residential consents for 2023 (49,000 in 2022)
- Rental bond lodgements increasing, suggesting a strong market for landlords, particularly with record immigration and interest deductibility set return
- Commercial construction prices up 6.5% to year Sept 2023, with value of annual consent approvals remaining at record levels of \$9.7bn
- Renovations and retrofit projects dominate the high number of education, office and retail building consent approvals in 2023, rather than new builds - average school project value at \$1.25m

FUTURE

- New residential consent approvals falling and to remain under 34,000 annually for the next 5 years - with standalone houses representing the majority of consent approvals
- The value of commercial consent approvals forecast to stabilise over the next 4 years
- Inflation continues to fall with predictions now for OCR cuts to start in 2025 heading to 3.5% by end 2026
- Globally, the forecasts for construction of residential and commercial buildings remains weak, particularly in Europe and China
- Weaker demand for building materials globally, suggests opportunities for cheaper imported materials

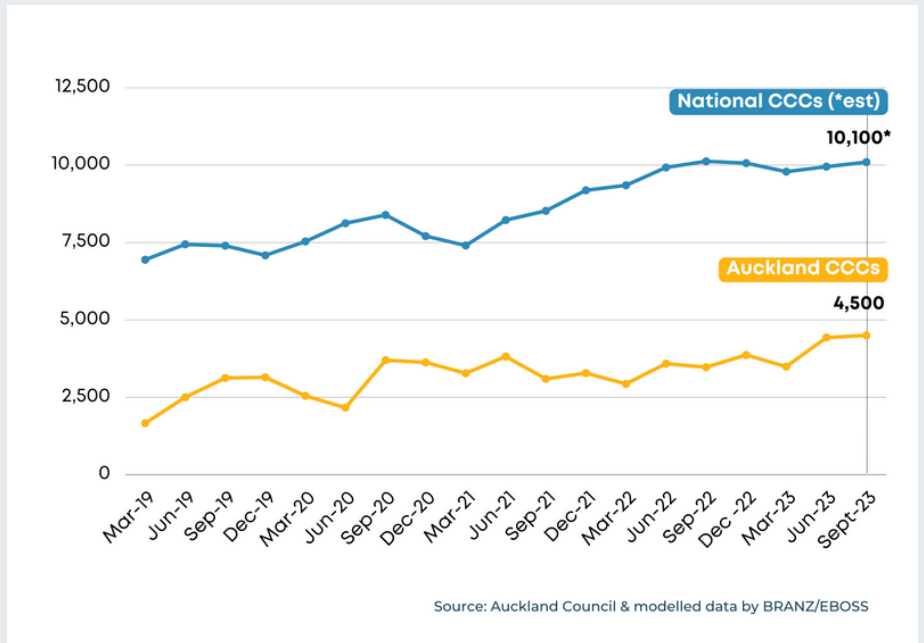
YESTERDAY

— Work completed

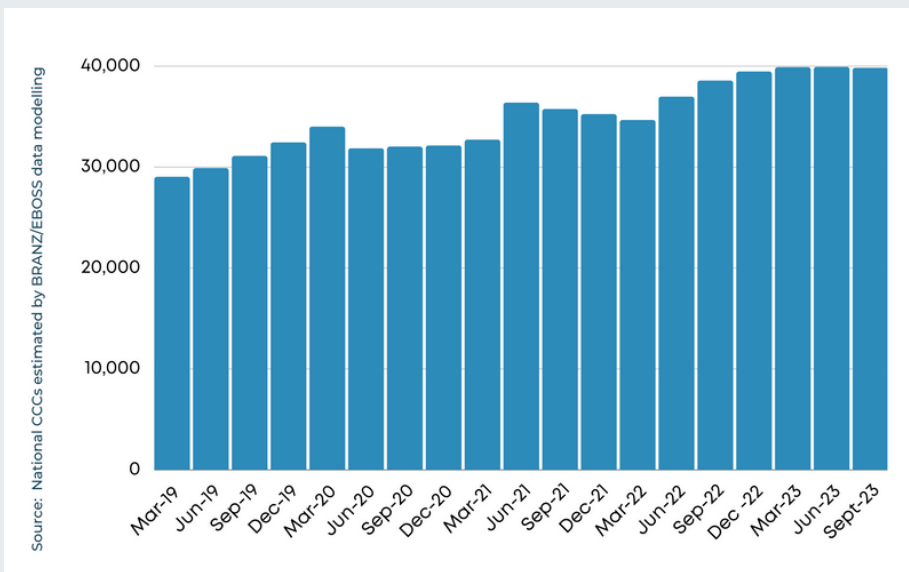
In the continued absence of national Code Compliance Certificates (CCCs) data from Stats NZ, we've further refined our estimation model with expertise from **Matt Curtis, BRANZ Economist**.

Estimated CCCs - National and Auckland Region by Quarter Period: Mar-19 to Sept-23

- Using the new model we estimate 10,100 residential dwellings were completed nationally in the third quarter of 2023 - similar to the same period in 2022
- Actual Auckland Council CCCs saw 4,500 homes completed in the September quarter - the highest on record
- This represents 45% of total national completions and an increase of 28% on Q3 2022



Estimated National CCCs - Quarterly 12-month Rolling Period: Mar-19 to Sept-23

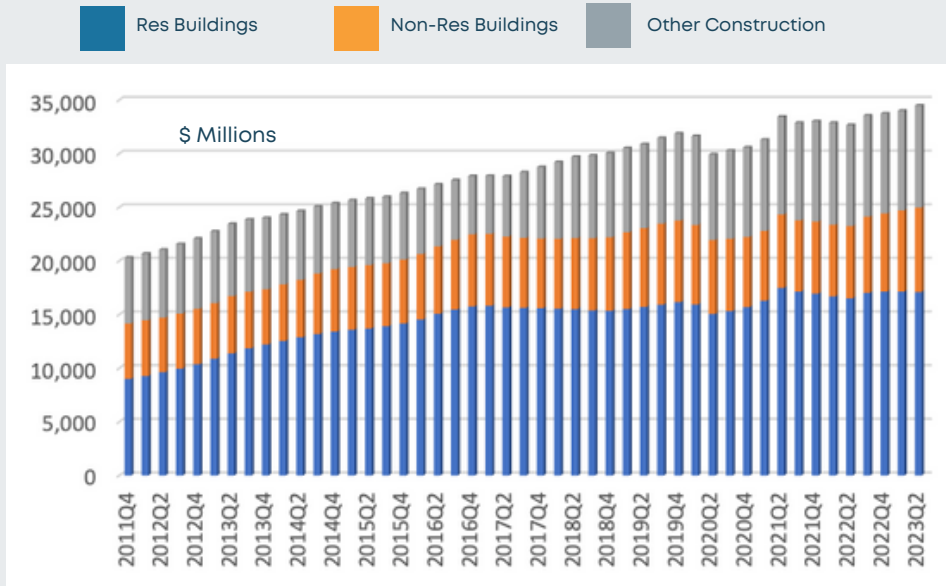


- Turning to a rolling 12-month perspective, our estimate of completions in new residential has reached its peak at just under 40,000 CCCs issued for the year ending Sept 2023
- The high level of consenting in the latter half of 2022 should continue to drive strong CCCs over the next couple of quarters
- We estimate that 20% of consents (10,000) did not proceed from the record 50,000 in 2022



YESTERDAY

Gross Fixed Capital Formation Period: Dec-11 to Jun-23



Source: Stats NZ | BRANZ

- Construction activity remains strong as measured by expenditure on residential buildings, non-residential buildings, and other construction
- Growth in residential sees it contributing 50% of total activity over the previous 12 months
- Non-residential buildings and other construction have not had the same growth in output over the last few years

Whose Borrowing What - FHB v Investor v Other Owner Period: to Dec-23

	Previous years:			Monthly:			
	Dec 2021	Dec 2022	Aug 2023	Sep 2023	Oct 2023	Nov 2023	Dec 2023
Total lending (\$million)							
All borrower types	7,931	5,121	5,782	5,194	5,778	6,539	5,304
First home buyers	1,562	1,110	1,368	1,253	1,369	1,558	1,335
Other owner-occupiers	4,978	3,020	3,340	2,965	3,293	3,770	3,008
Investors	1,310	913	986	894	1,021	1,138	894
Business purposes	81	78	88	82	95	73	68

Source: Reserve Bank of New Zealand

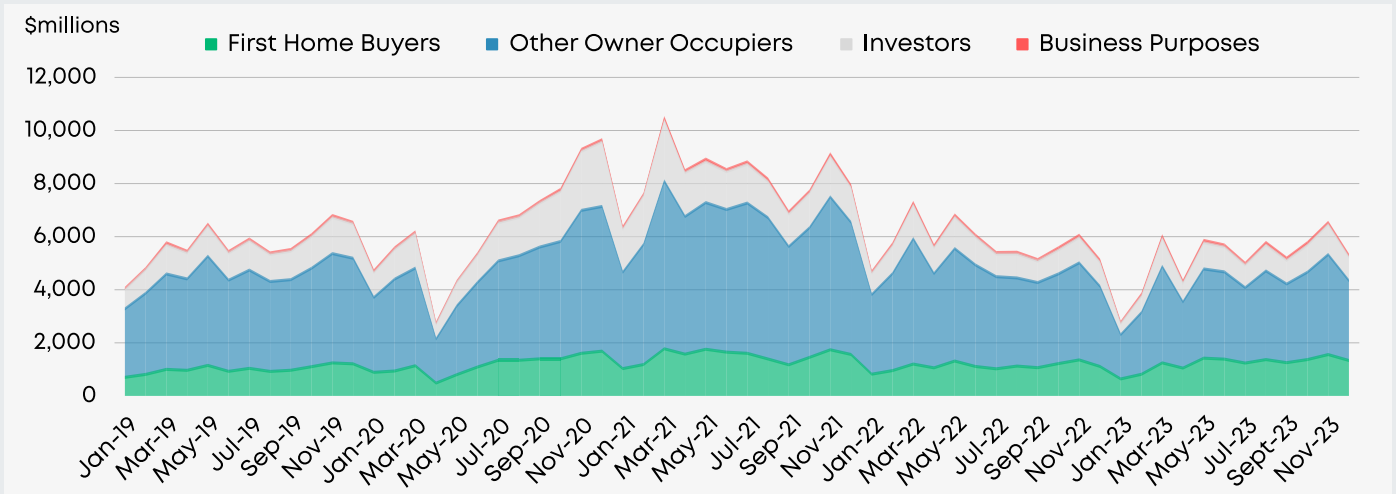
- Overall mortgage lending hit \$17.6bn in the last quarter of 2023, almost a billion more than the same quarter in 2022, but more than 25% off the peak in 2021
- Compared to those record levels seen in 2021, owner occupier and investor activity has fallen back the most

- First Home Buyers have remained very active last year, taking advantage of lower house prices, even though interest rates and loan serviceability have remained challenging with the OCR at 5.5%
- Since July 2022, lending to First Home Buyers has been higher than lending to investors
- And FHB lending represents 24% of total new lending over the last quarter



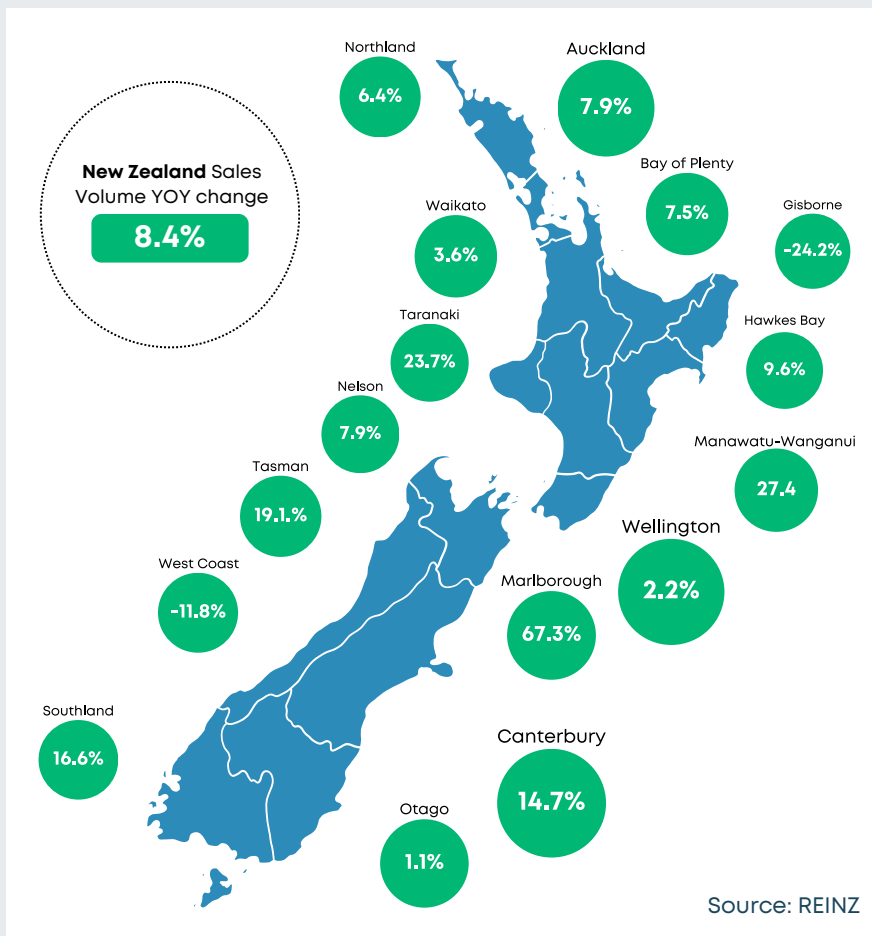
YESTERDAY

Mortgage Lending by Borrower Type Period: Jan-19 to Dec-23



Source: Reserve Bank of New Zealand

Residential Property Sales Volume YOY Change by Region Period: Sept-22 to Sept-23 (seasonally adjusted)



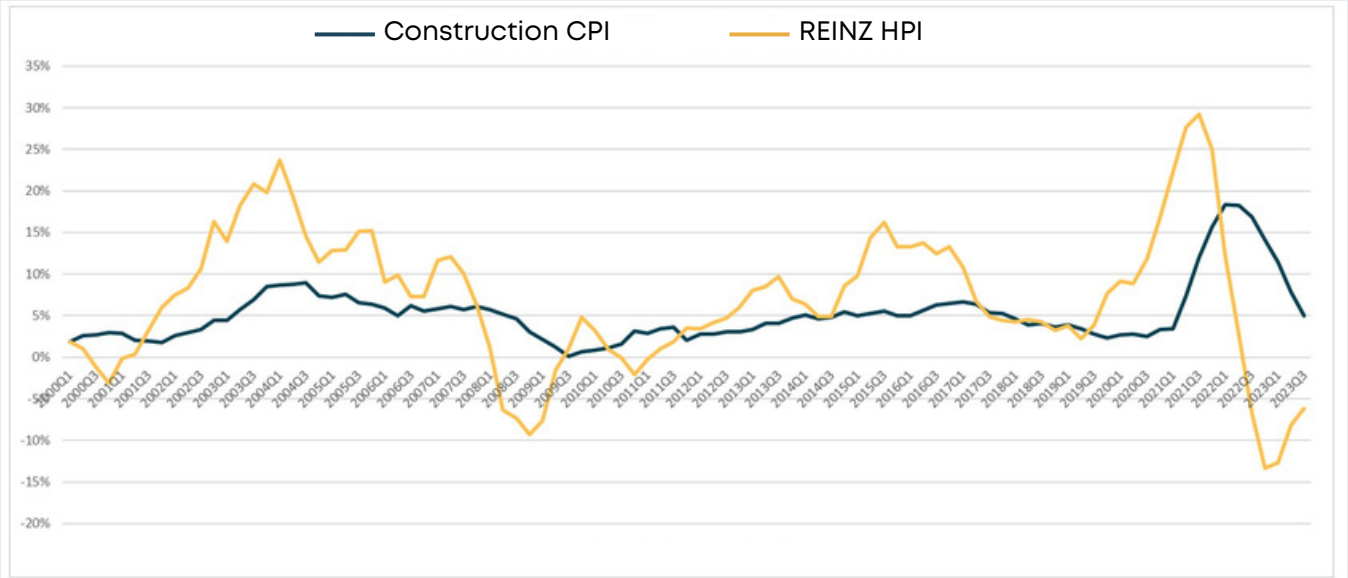
Source: REINZ

- Sales volumes were up in nearly every region in Sept 2023 compared to Sept 2022, with only Gisborne and West Coast bucking the trend
- However these volumes are off a fairly low base and with interest rates still high, the expectation is for activity to rise slowly from here
- See inflation chart overleaf - despite house prices fluctuating quite significantly since 2000 with the impacts of interest rates and net migration demand, construction cost inflation has been relatively stable, largely keeping within a band between about 3% and 6%.
- The post COVID significant rise in construction costs has eased back to 5%. At the same time, house prices have started to rise, narrowing the gap between the cost to build and cost to buy



YESTERDAY

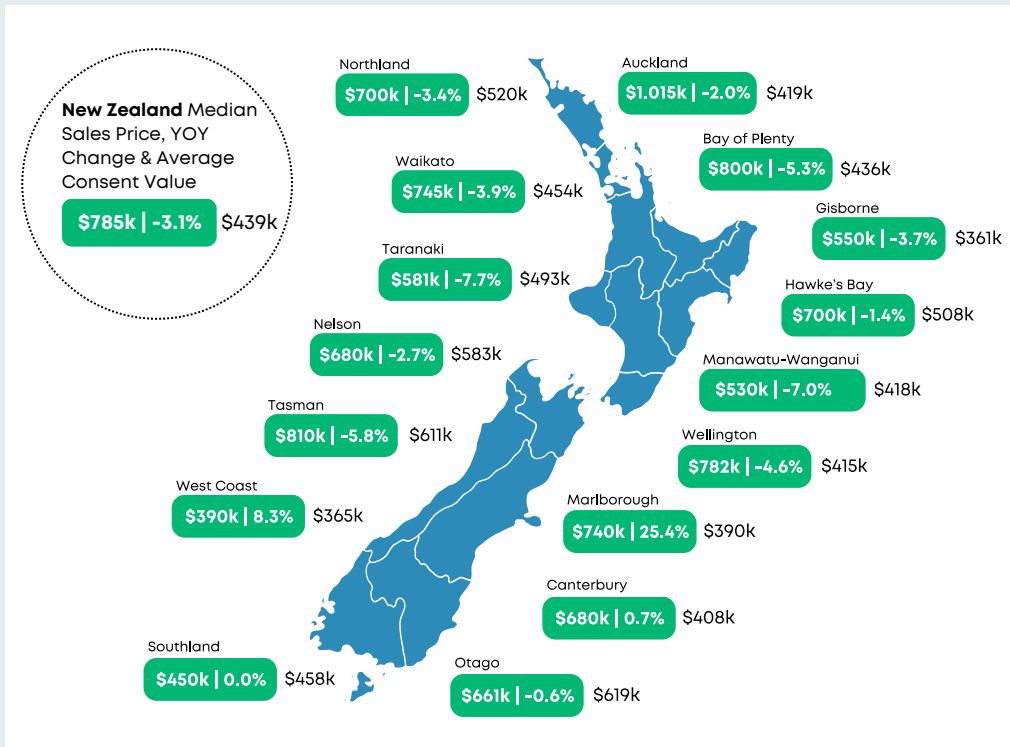
Construction Cost Inflation vs House Price Inflation Period: Q1 2000 to Q3 2023



Source: REINZ | Stats NZ

Cost of New Builds v Existing

Period: Sept 2022 to Sept 2023



Source: REINZ | Stats NZ

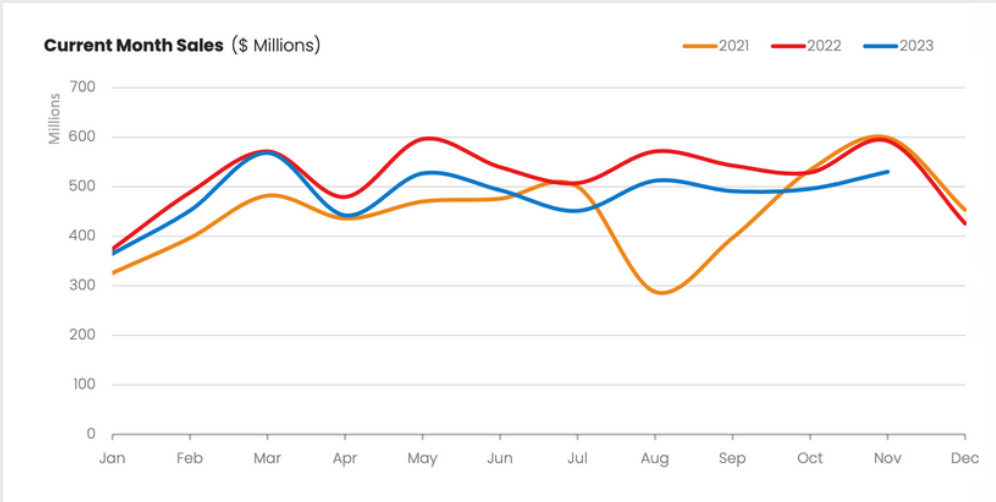
- Here we compare REINZ regional house price sales to the consented cost of new buildings
- Median house prices have started to increase of late across most of the country. Whilst prices are lower than this time last year, they're still well below the peak in late 2021
- The increase in house prices over the past few months has been patchy and slow, and with interest rates still high, expect house prices to rise gently, rather than surge.



TODAY

— Work currently under construction

Building Merchant Current Month Sales Period: Monthly to Nov-23



Month-on-Month

↑ **6.9%**

Monthly sales increased by 6.9% from October 2023 to November 2023.

Year-on-Year

↓ **10.5%**

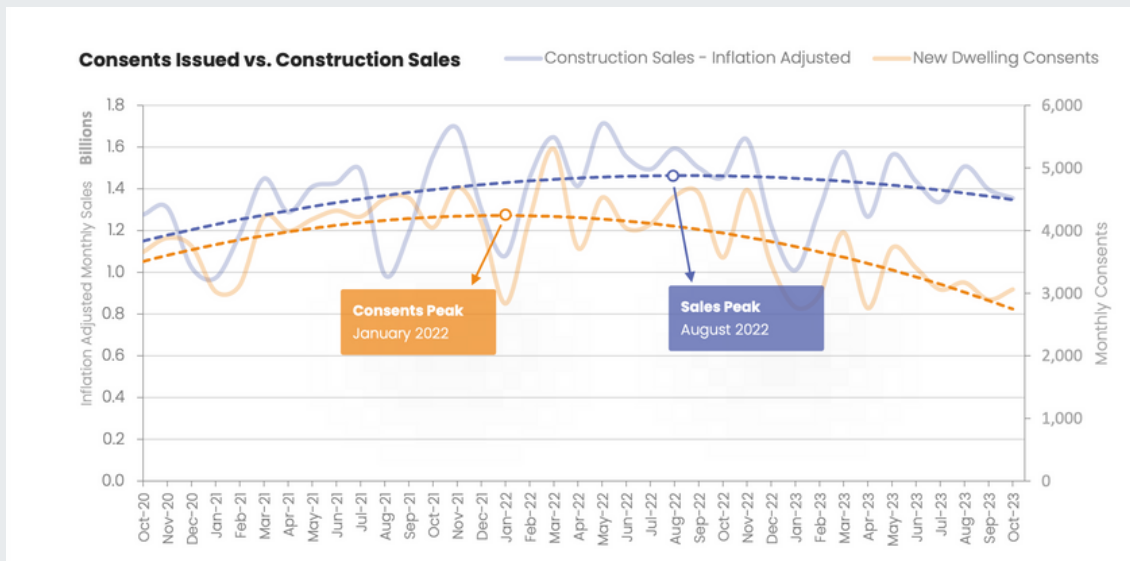
Monthly sales for November 2023 were 10.5% lower than November 2022.

Source: CreditWorks

- 2023 is consistently 7-12% down compared to 2022
- November represents a spring 'leap' with monthly sales increasing to \$500m, but still 10.5% under the record levels seen in 2021/22
- The chart below 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
- The respective peaks of these trend lines show a 7 month lag between consents issued (Jan 2022) and overall construction sales (Aug 2022)

Construction Sales Value vs New Dwelling Consents Issued

Inflation Indexed to CPI | Base 1000 = Dec-19



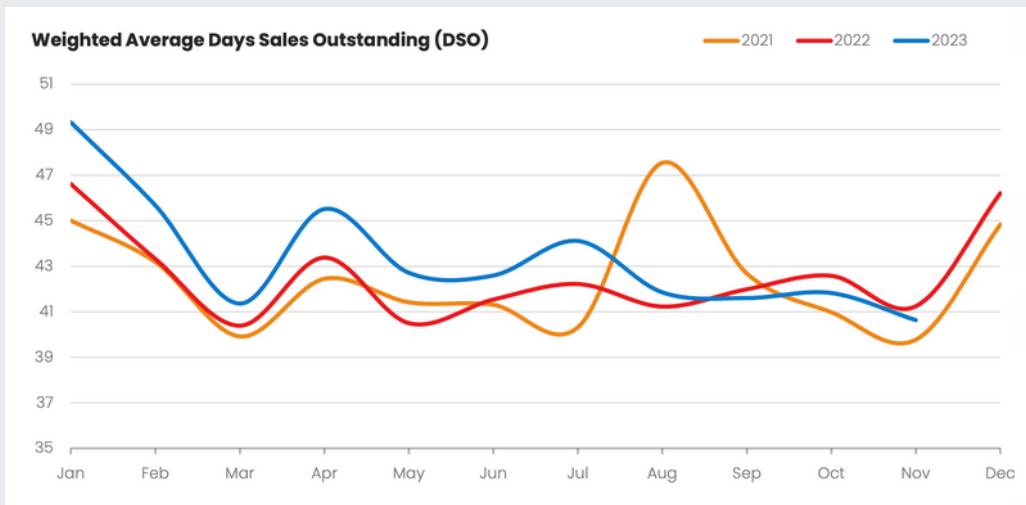
Source: CreditWorks | Stats NZ

TODAY

- The working hypothesis is that if consents begin to show a sustained upswing in volume, overall construction-related sales volumes can expect a return to growth mode circa 7 months later
- Given the process of construction, the lag between consents and sales will inevitably be different for the various trades and product suppliers involved at each stage

Building Merchant Days Sales Outstanding Period: Monthly to Nov-23

How long it takes Building Merchants to collect their account receivables



Source: CreditWorks

Month-on-Month

↓ **2.9%**

Weighted average DSO decreased by 2.9% from Oct-23 to Nov-23.

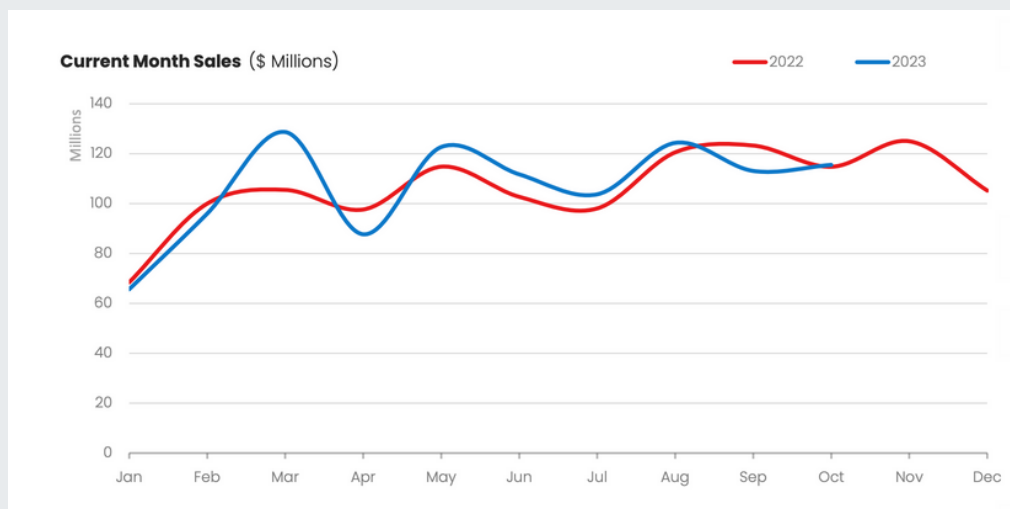
Year-on-Year

↓ **1.5%**

Weighted average DSO was 1.5% lower in Nov-23 vs Nov-22.

Concrete Merchant Current Month Sales

Period: Monthly to Oct-23



Source: CreditWorks

Month-on-Month

↑ **2.1%**

Monthly sales increased by 2.1% from September 2023 to October 2023.

Year-on-Year

↑ **0.6%**

Monthly sales for October 2023 were 0.6% higher than October 2022.

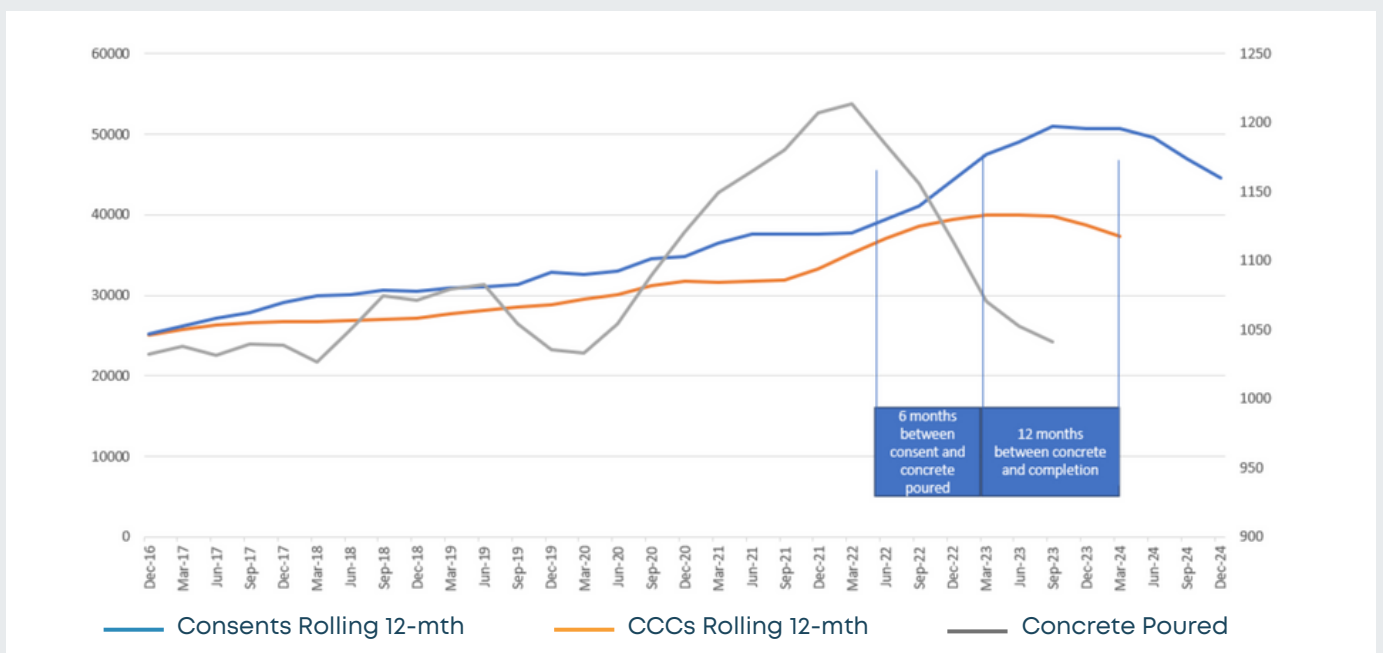


TODAY

- On average, the typical time between consent approval and completion is around 18 months
- This can comprise of around 6 months preparation (before concrete is poured) and then 12 months of building work
- If we look at the trend for consenting and concrete poured, we can get an indicator of the likely activity and the number of completed dwellings in future
- The chart below shows that concrete poured peaked in Mar 2022 and has fallen since then

Completions (CCCs) v Concrete Poured v Consents (lagged 18 months)

Period: Quarterly Dec-16 to Dec-24



Source: Stats NZ | BRANZ

- Whilst the above covers all readymix concrete, including commercial uses, the general trend is a leading indicator of building activity and completions, suggesting that the amount of building activity and completions will fall across 2024
- This also demonstrates how the number of completed dwellings was closely aligned to consents, but is now falling away suggesting that many consents issued during the peak of consenting aren't converting into an actual build with BRANZ observing an increased number of refund requests for building levies

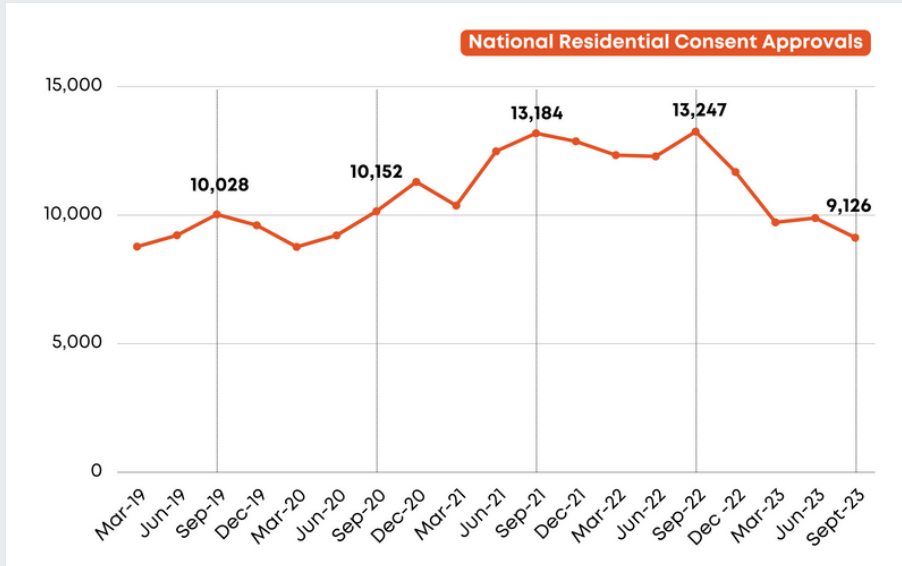


TOMORROW

Work consented, but not yet constructed

Quarterly Number of Current Residential Consent Approvals

Period: Mar-19 to Sept-23

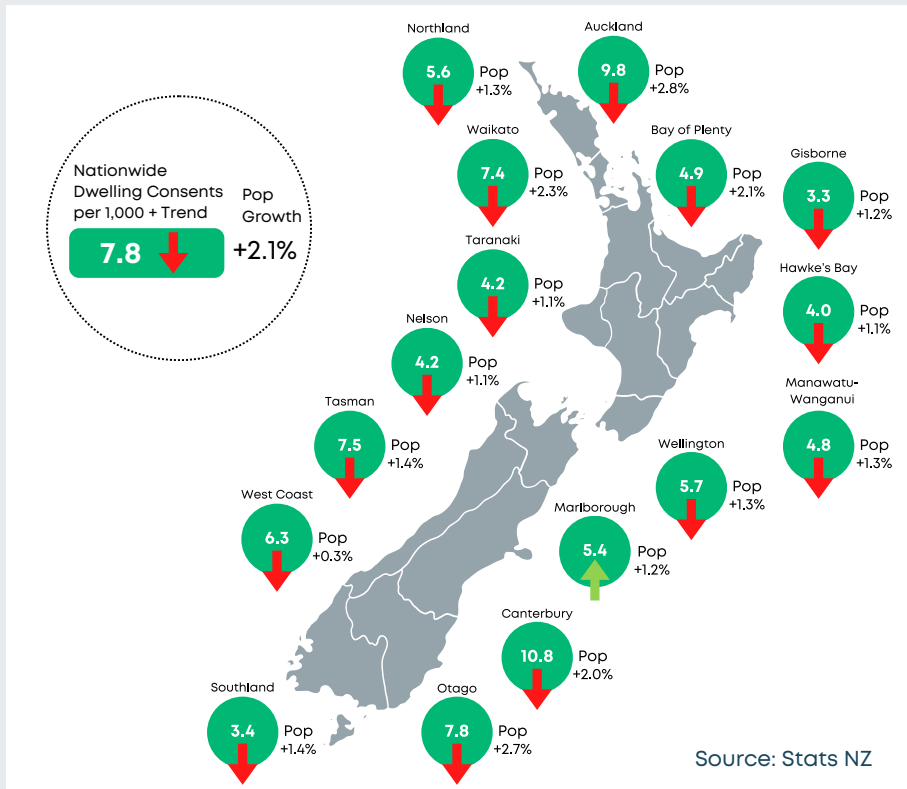


Source: Stats NZ

- Consent approvals are down 31% for the quarter ending Sept 2023 compared to record levels in 2022
- Approvals are now back to levels last seen in 2019

Dwelling Consents per 1,000 Population by Region with Trend

Direction and Population Growth Period: Year to Sept-23



Source: Stats NZ

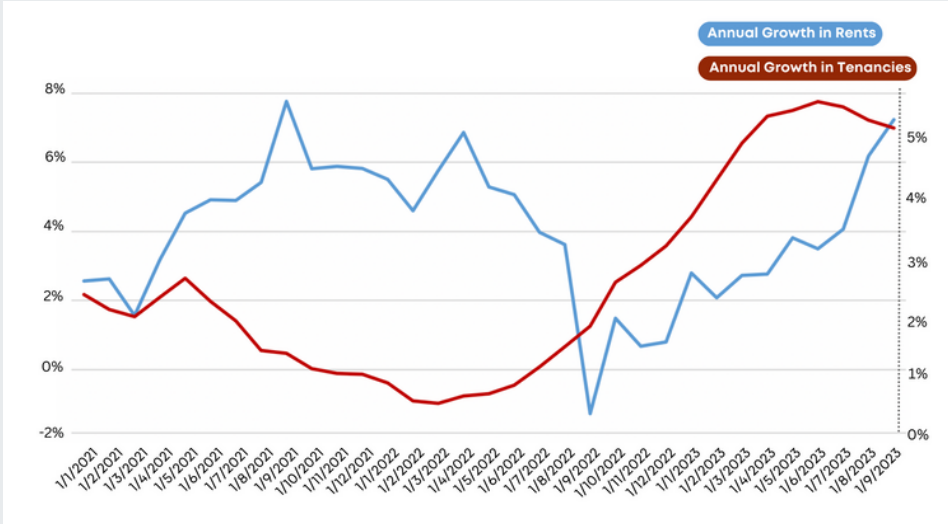
- Building Consent issuance has been trending downwards across most of the country, but comparing issuance per 1,000 population in each region shows a large variance in construction intentions across the country
- Whilst the national average is 7.8 per 1,000, the regional number ranges from only 3.3 in Gisborne, 3.4 in Southland, 4 in Hawke's Bay at one end of the scale to Canterbury and Auckland with 10.8 and 9.8 respectively



TOMORROW

Rental Bonds Trends

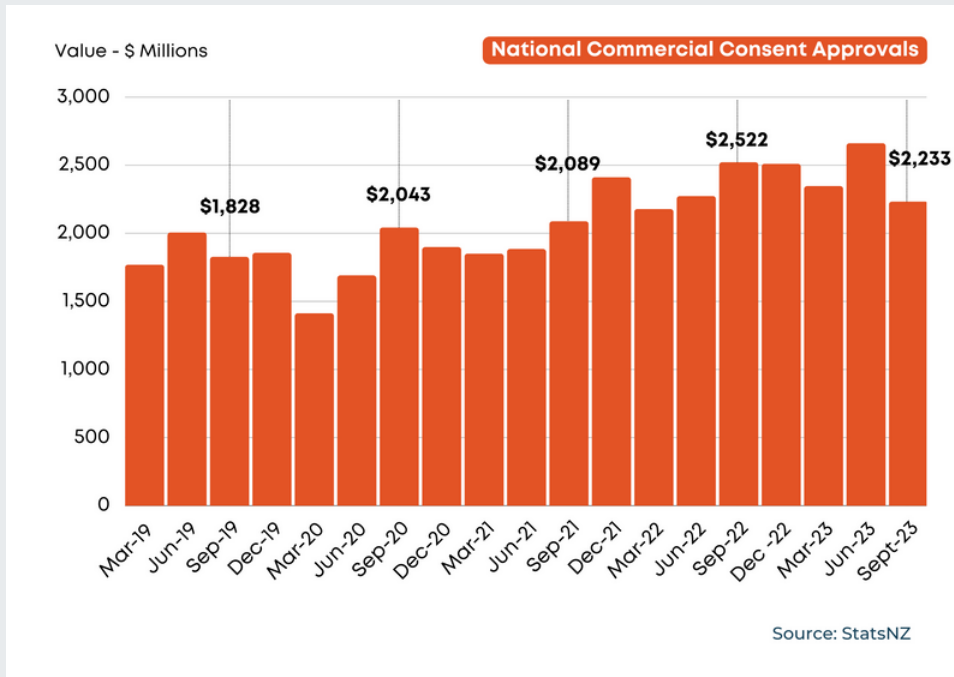
Period: Jan-21 to Sept-23



- Despite concerns from landlords, we have not seen any material selling off of rental property. The number of rental bonds lodged has continued to rise, hitting nearly 5% annual growth in June 2023
- This increase coincided with the rise in net migration particularly in Auckland where migrants tend to settle first
- That demand has driven rent price inflation up nationwide to 7.2%

Quarterly Value of Current Commercial Consent Approvals

Period: Mar-19 to Sept-23



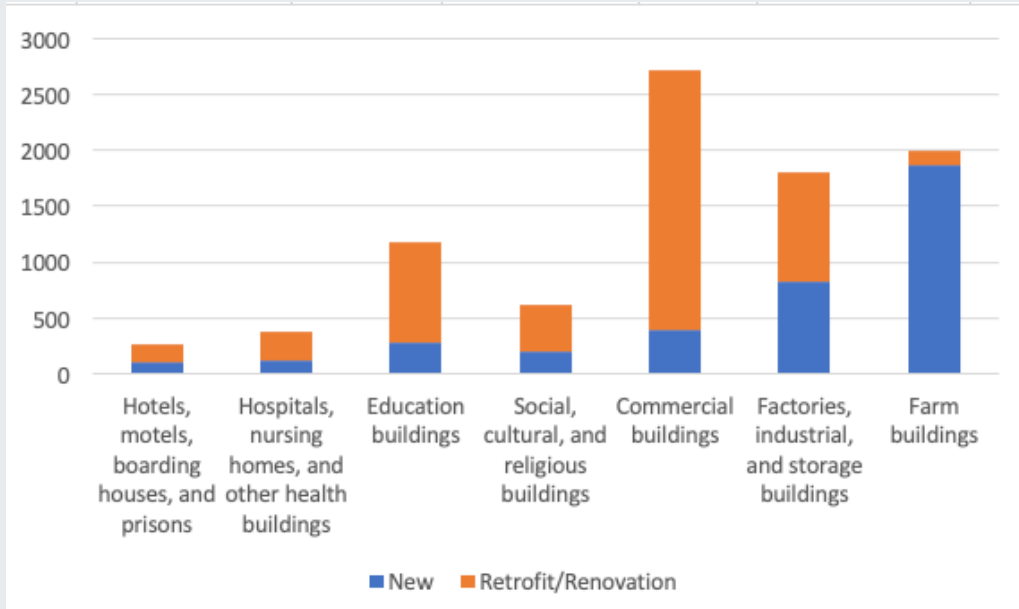
- Turning to commercial consent approvals by value, the quarterly levels fluctuate because of the influence of large single projects, but approvals remain steady and consistent
- This series is influenced by price changes with non-residential construction prices (as measured by the capital goods price index) up 6.5% in the year ended Sept 2023



TOMORROW

Number of New Commercial Consent Approvals Year-ending Q3 | 2023

By Type and New vs Refit/Renovation

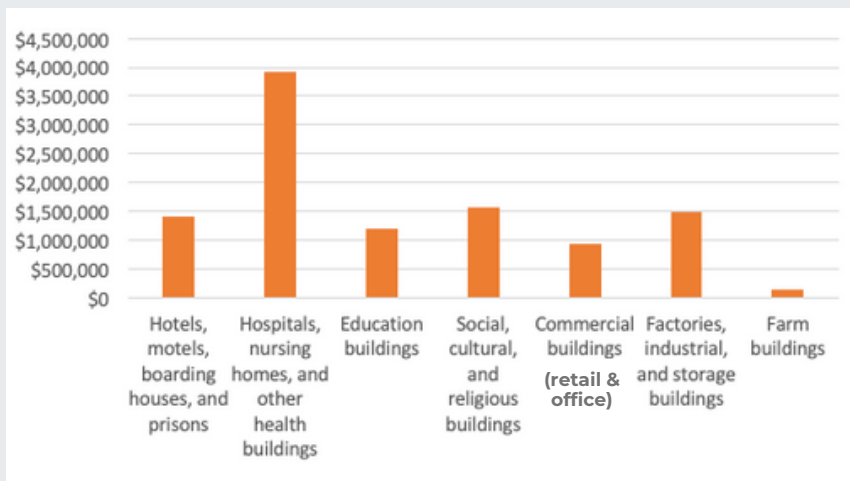


Source: Stats NZ

- Commercial buildings (retail & office) were the dominant building type over the past 12 months with over 2,700 total building consents. The vast majority of these were alteration/addition consents (85%) and typically represent fit-outs
- Farm buildings were the next most consented building type, but have a significantly different profile, typically new builds

Value of Commercial Approvals Year-ending Q3 | 2023

By Type and Average Value



- There were a relatively small number of health building consents, however the average value over the last 12 months was almost \$4m
- Accommodation, education, community and industrial buildings all had an average value of over \$1 million.

Source: Stats NZ



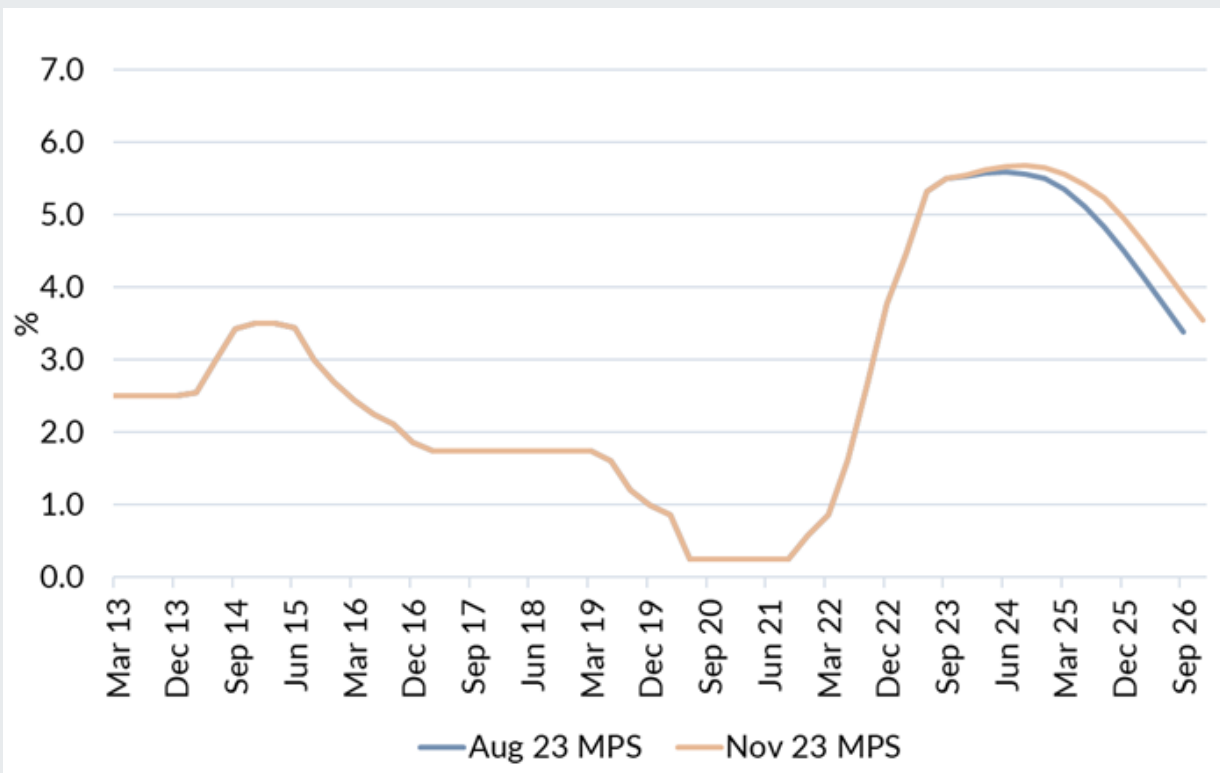
FUTURE

Neither consented or constructed yet

- The unemployment rate rose from 3.6% in June to 3.9% in September. This was slightly higher than the RBNZ’s estimate of 3.8% for September and suggests the central banks efforts to slow down the economy are having an impact
- The unemployment rate is expected to jump up toward mid-4’s in the current quarter and climb further in 2024. Overall wages grew 4.3% in the year to September, but this was supported by strong public sector wage growth while the private sector lagged
- Inflation eased to 5.6% over the year to September, down from 6.0% in the year to June aided by a drop in the price of imported goods and services. Non-tradeable inflation (i.e. domestically driven inflation) however was slightly higher than the RBNZ’s forecasts
- Overall, labour market capacity is freeing up, wage growth is generally easing, and CPI is coming down broadly in line with the RBNZ’s forecasts

Reserve Bank of New Zealand - Official Cash Rate Actual and Forecast

Period: 2012 to Sept-26



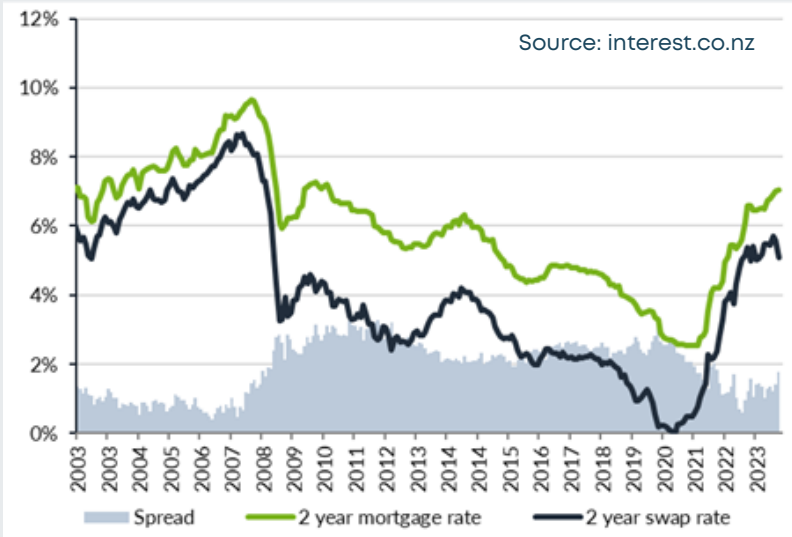
Source: RBNZ | MPS = Monetary Policy Statement

- The November MPS impact shown above suggests the OCR may stay higher for longer
- The RBNZ forecasts the potential for another OCR increase in 2024 and does not expect cash rates to decline until early 2025 before a gradual reduction to 3.5% by the end of 2026



FUTURE

Mortgage Rates - 2003 to 2023: 2yr Swap & Fixed Rates

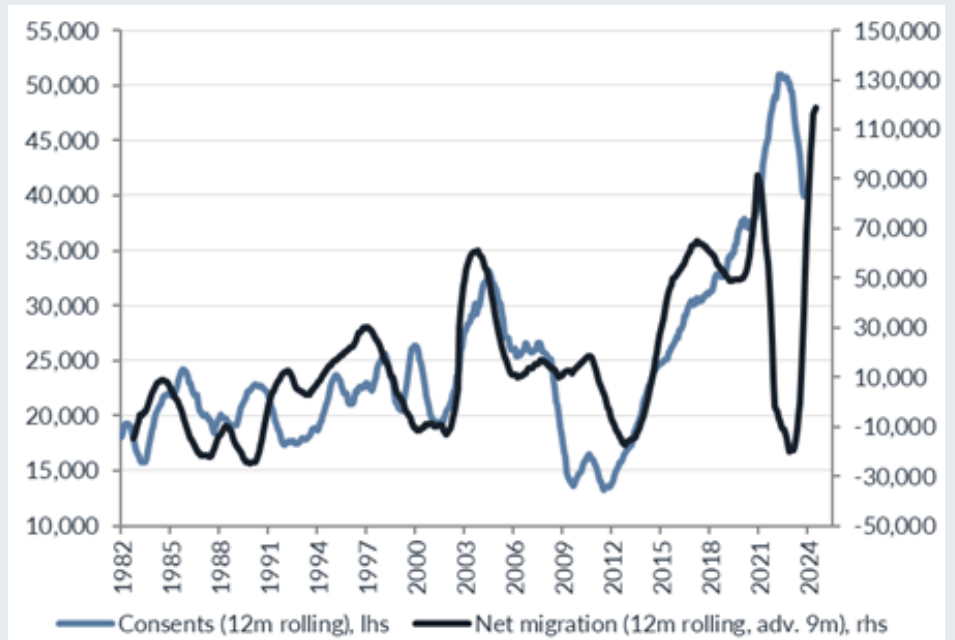


'Swap Rate' is the rate at which NZ banks borrow to lend at a fix rate to the public.

- Mortgage rates have continued to creep higher over recent months partly due to higher funding costs (swap rates) but largely due to banks restoring their margins which had become compressed as funding costs rose
- With swap rates coming off recent peaks due to weaker global economic data the banks margins are almost back to more normal levels
- As such, further falls in funding costs might see mortgage rates come off their peaks – however we caveat this with the fact that there have been a number of false peaks this rates cycle

- Net inward migration is at record levels and was +118,000 over the last 12 months
- Migration is typically a medium term driver of housing demand and the RBNZ estimates that there is a circa 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 opposite

Residential Building Consents v Net Migration Source: Stats NZ



- Current migration levels and natural population growth suggest 47,000 dwellings are required based on historical relationships, however building consents are falling
- 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

Royal Institute of Quantity Surveyors (RICS) Global Construction Monitor | Q3 2023

- Global construction activity is still rising modestly thanks in the most part to continued high levels of infrastructure investment
- Financial constraints and material costs are still seen as the largest impediments globally

Global: 12-Month Workload Expectations by Region



Source: RICS - GCM Q3 | 2023

- The chart to the left confirms the scale and importance of infrastructure spending in all regions
- For the Americas and Middle East in particular, the Q3 results show expectations being upgraded relative to the last quarter
- APAC survey contributors foresee infrastructure workloads rising in the year ahead

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



Source: RICS - GCM Q3 | 2023

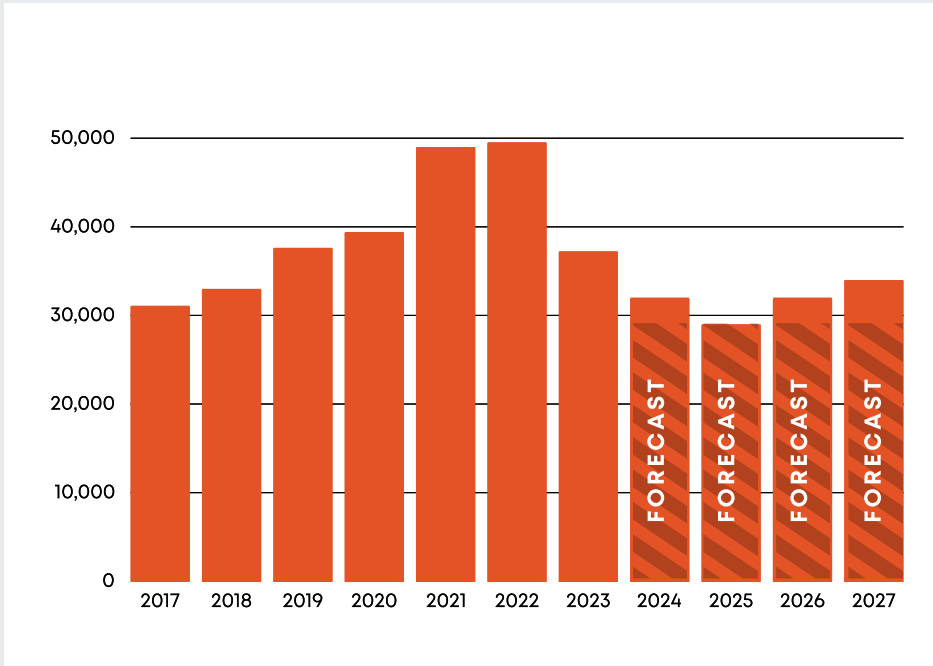
- The survey results for Europe point to a further deterioration in trends across the construction sector, with tightening credit conditions and a weak economic outlook weighing on activity
- Expectations are cautious for both residential and non-residential building work and profit margins
- Feedback across most nations (except Ireland) points to a flat or negative trend for the coming 12 months



FUTURE

Residential Dwelling Consent Actuals and Forecasts

Period: 2017 to 2027

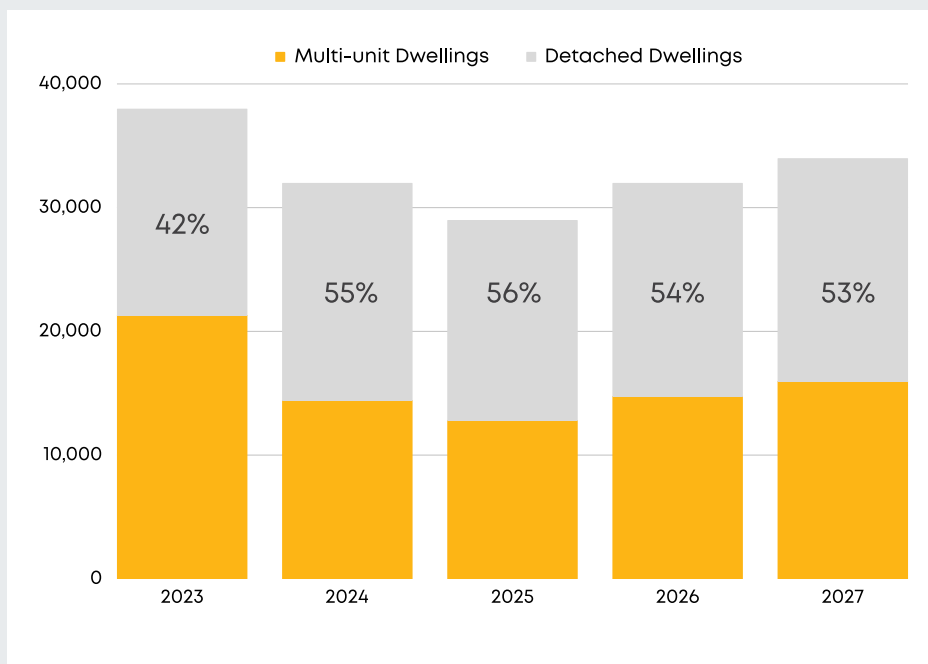


Source: BRANZ

- BRANZ forecast new residential building consents to fall away from the record highs of the last couple of years - falling to 29,000 in 2025
- The expectation is for standalone housing to be the dominant building type over this period, expected to represent 52% of dwellings consented over the next 5 years
- 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:

Residential Dwelling Consent Forecasts

Multi-unit Dwellings vs Standalone Houses Period: 2023 to 2027



Source: BRANZ

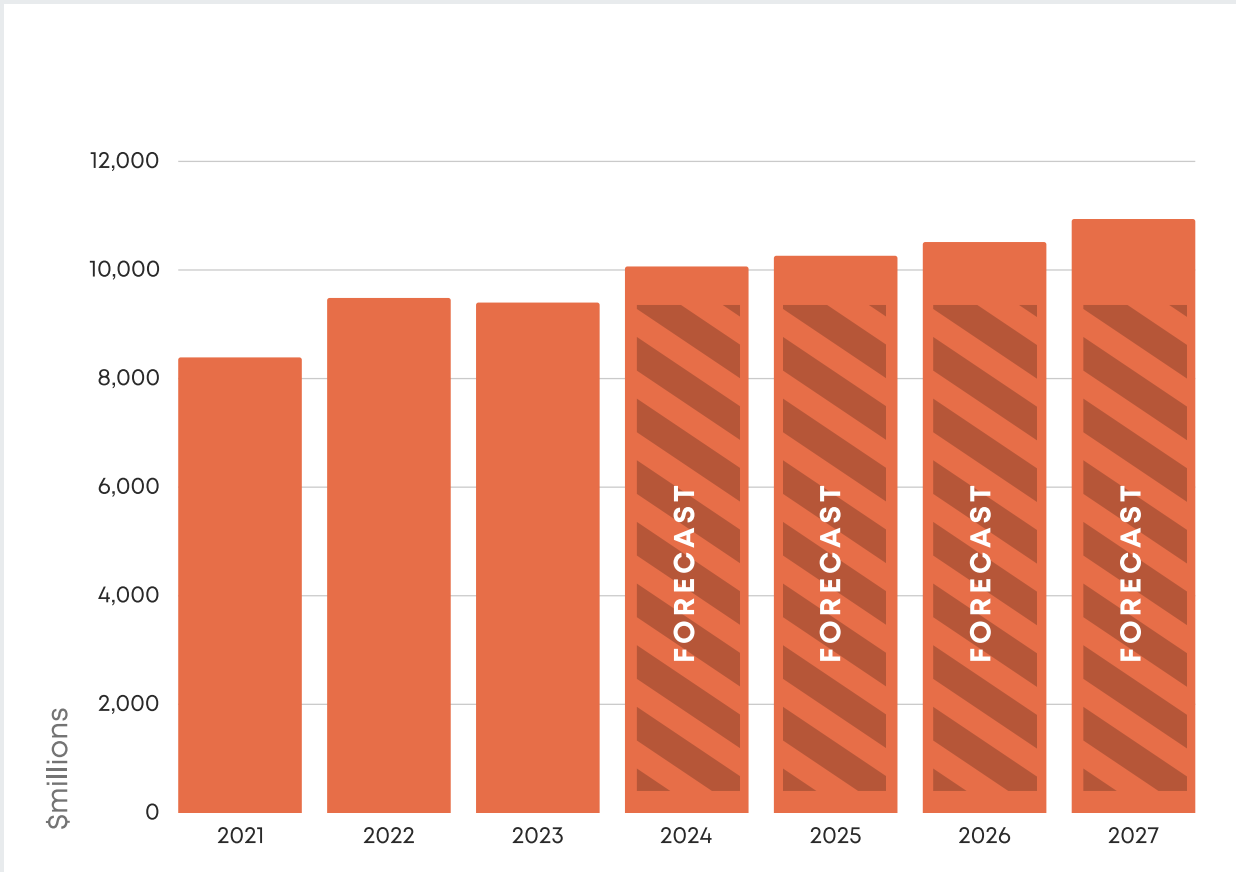
1. Standalone dwellings are more resilient to changing economic conditions than multi-units
2. The long lag time between planning and consents for multi-units means that consent numbers have remained higher for longer
3. Banks will typically require pre-sales for multi-units which can be difficult
4. High build costs can make the feasibility of brownfield development uneconomic
5. And likely changing government policies from infill housing to greenfield developments will impact too



FUTURE

BRANZ Annual Commercial Consents Value - Actuals and Forecasts

Period: 2021 to 2027



Source: BRANZ

- We expect non-residential activity to remain relatively strong against the headwinds facing the residential sector
- Our forecast is for increases in consent values to be in line with inflation through to 2026, and workloads to remain at similar levels to the last 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
- A large number of relatively small education projects are also in the pipeline



THANKS TO OUR CONTRIBUTORS



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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.

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