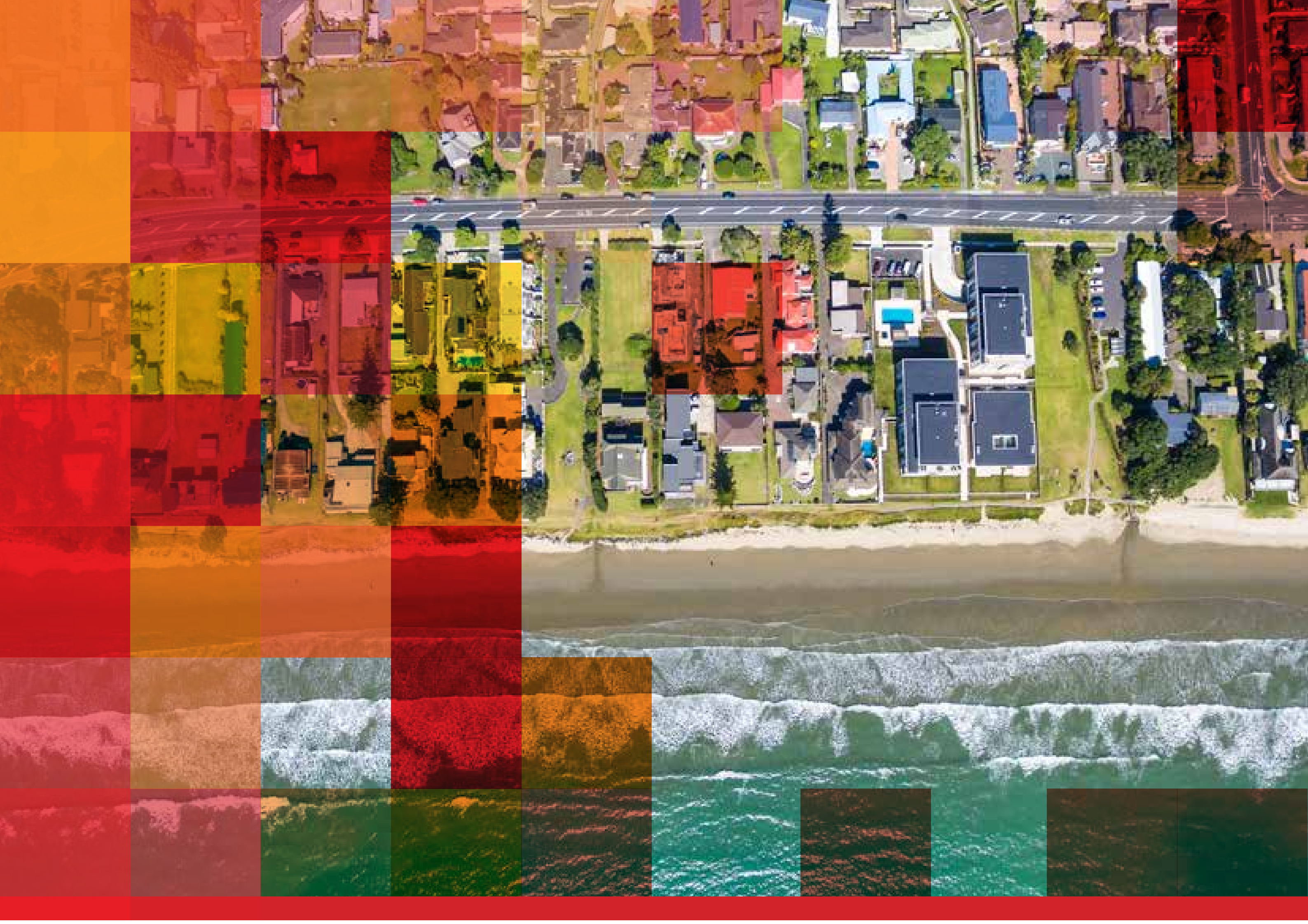


FUSE

7 SEPTEMBER 2016

BOOMING RESIDENTIAL CONSTRUCTION INCREASES THE RISKS AND REWARDS FOR THE CONSTRUCTION SECTOR

IN THIS EDITION OF FUSE:

- Demand for new builds is high with building consents at record levels
- The median sale price for new homes and apartments currently being constructed in Auckland are at the higher end of the residential property market
- Modest year-on-year increase in overdue payments by construction sector firms
- Construction firms are managing higher debt levels, however monitoring is required

The New Zealand property market has experienced rapid growth over the last 18 months as demand outstrips supply across most parts of the country.

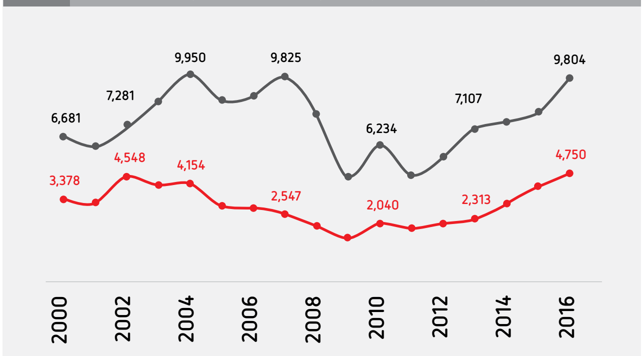
This month Fuse takes a look at the construction industry and the impact the current rise in building activity is having on the industry's current debt profile.

NEW BUILDING CONSENTS ON THE RISE

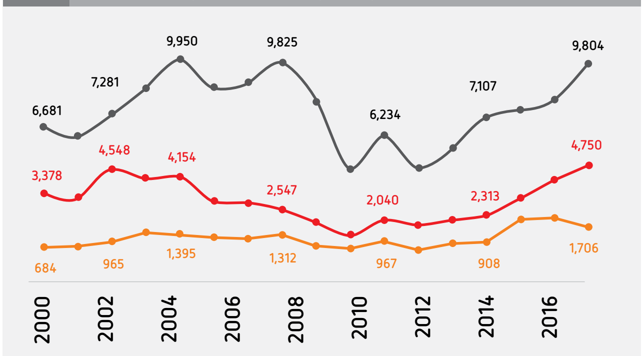
New statistics released by Valocity show the number of building consents granted for new dwellings across New Zealand are now at their highest level of the 21st century.

FIGURES 1A & 1B

1A Consents issued nationally, 1st January to 31st July only for each year



1B Christchurch consents, 1st January to 31st July only



Auckland   Rest of New Zealand

*Consents data taken from new dwelling consents issued by the councils

Auckland   Rest of New Zealand   Christchurch

Building consents last peaked in the early 2000's before taking a sharp dive between August 2007 and January 2009 due to the downturn in both the national and global economies as a result of the GFC (Global Financial Crisis).

In 2010, New Zealand's appetite for new builds began to recover and has continued to steadily track upwards to today's levels of growth which has not been seen since 2003.

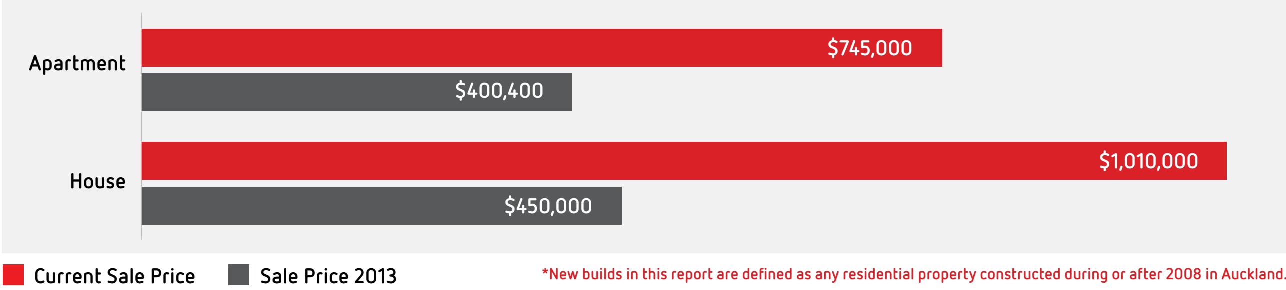
Building consents in Auckland now consist of a third of all total consents issued nationally which is on par with the city's population density. However, in the past five years on average only 25% of total building consents nationally have been granted in Auckland which is well below expected levels given immigration and population projections for the country's largest city.

Christchurch offers an obvious exception to the current trend with records indicating a decline in building consents post the 2011 earthquakes. Consents peaked in November 2014 but have since continued to trend downwards as the rate of the rebuild plateaus.

FIGURE 2

MEDIAN SALE PRICE FOR NEW DWELLINGS IN AUCKLAND TOPS $1 MILLION

2 New build median sale price, 2013 vs. now



*New builds in this report are defined as any residential property constructed during or after 2008 in Auckland.

New figures reveal that not only has the median sales price of a newly built home in Auckland increased, from $450,000 in 2013 to $1,010,000 in 2016, the median sales price of apartments has also increased by 86% to $745,000 since 2013. This indicates that although intensification of housing stock is touted as the way to increase affordability, at present the nature of new builds and apartments being constructed are targeted at the higher end of the market.

In addition, the difference between the median sales price of new builds and existing dwellings has also significantly increased from 5.6% in January 2013 to 23% in May 2016.

It is also evident that demand for new builds has strengthened significantly since the Reserve Bank exempted loans for new construction from the LVR restrictions imposed in October 2013.

Whilst only a small snapshot into the supply demographics of the Auckland housing market, what can be concluded from the above analysis is that the new housing stock being constructed in Auckland is positioned at the higher end of the residential property market.

↑86%

SINCE 2013, THE MEDIAN SALES PRICE OF APARTMENTS IN AUCKLAND HAS INCREASED TO $745,000

↑44%

TOTAL CONSENTS FOR APARTMENTS AND TOWNHOUSES IN AUCKLAND HAVE INCREASED FOUR-FOLD SINCE 2013

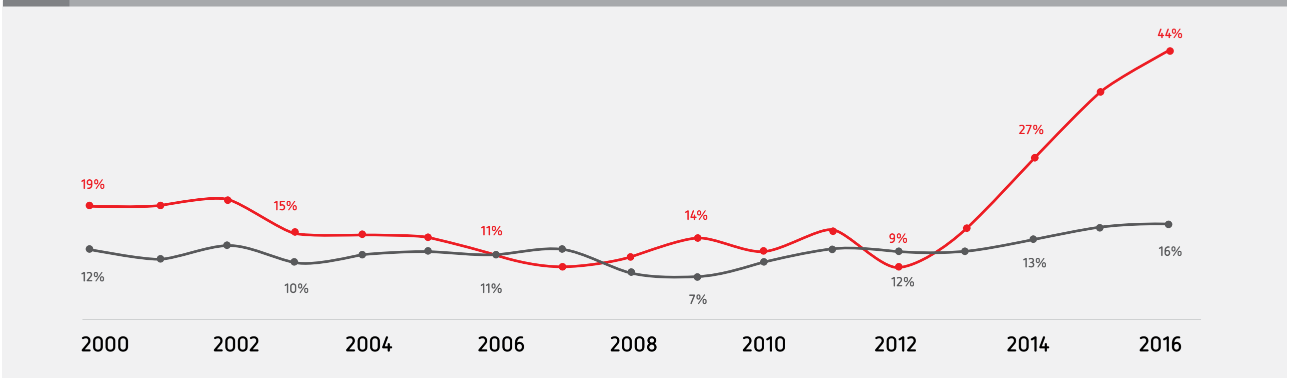
THE RISE OF THE APARTMENT

Latest figures also reveal that consent numbers for apartments and townhouses in Auckland have increased four-fold since 2013 to 44% of total consents issued in 2016 - which is a major step forward towards meeting the increasing need for intensification required to achieve affordable homes in a growing population.

FIGURE 3

PERCENTAGE OF NEW BUILDS

3 Percentage of new builds that are apartments / townhouses, 1st January 2010 to 31st July 2016



Auckland   Rest of New Zealand

*Consents data taken from new dwelling consents issued by the councils

The rise of apartments and townhouses across the rest of the country, however, has remained pretty steady at, on average 11% of all consents issued.

HOUSING AND CONSTRUCTION DEBT CLIMBING

So what about the companies that built these newer dwellings? Payments records provide an insight into how construction sector firms in general are coping financially with the increase in activity and debt.

First some perspective on the amount of debt surrounding the housing market today.

Householders are borrowing more money to finance both new buildings and to purchase existing dwellings. The Reserve Bank has put a number on this lending: up 9% in the June 2016 twelve months to $221 billion[1].

Also of interest is the fact that builders, civil engineers, plumbers, plasterers, painters etc. (companies within the construction sector) are also borrowing more money. Their debt level to the banks increased 12% to almost $5 billion, albeit some of these funds are used to finance non-residential construction activity[2].

1 http://www.rbnz.govt.nz/statistics/c6

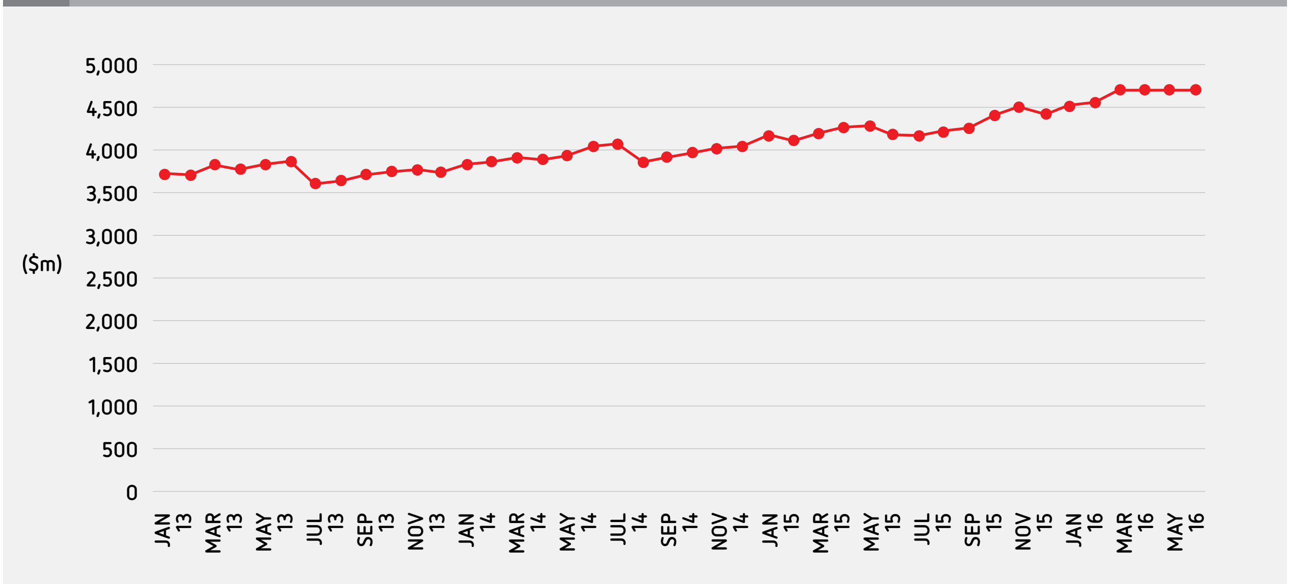
2 http://www.rbnz.govt.nz/statistics/s7

LENDING ON HOUSE PURCHASES AND NEW BUILDS IS UP 9% IN THE YEAR JUNE 15 – JUNE 16

FIGURE 4

BANK LENDING

4 Bank lending to the construction sector



*Source: RBNZ

THE LEVEL OF TRADE CREDIT PAYMENTS 90 DAYS OR MORE OVERDUE IS AT

2.5%

NATIONWIDE ACROSS ALL SECTORS

OVERDUE PAYMENTS INCREASING AMONGST CONSTRUCTION SECTOR FIRMS

Companies in the construction sector are managing higher debt levels. The facts show that:

- Companies within the construction sector have more overdue payments on average than firms in other sectors;
- And both the level and proportion of overdue trade credit payments by construction sector firms are increasing year on year at present.

However, there is currently no cause for alarm as the magnitude of the increased overdue payments ratio is modest and does not appear to be accelerating at present. It is also usual for the construction sector to include more slow paying firms. What is required, though, is prudent monitoring of debt levels and payment trends.

Nationwide and across **all sectors**, the level of trade credit payments that are overdue by 90 days or more is 2.5%. It was much the same 12 months ago, a sign that companies in general are not experiencing undue cash flow challenges. The same ratio amongst Auckland **construction sector** firms is 5.1%.

Looking beyond the strong seasonal effects, there is an increase in overdue payments amongst these firms from 4.4% twelve months earlier. However, in the context of the typical variation of this overdue ratio from month-to-month, this rise in overdue payments is not overly significant.

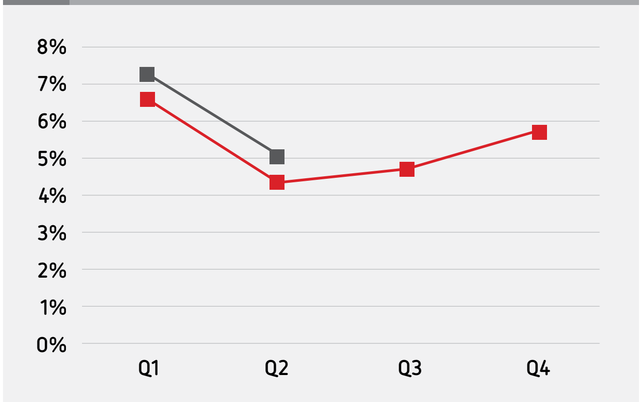
Data analysis also shows a rise over 12 months in the ratio of 90-day or more overdue trade payments amongst Canterbury **construction sector companies**, but again the rise was relatively modest. Now at 4.5%, the Canterbury ratio is less than in Auckland.

Elsewhere in the country the overdue **construction sector ratio** is lower again at 3.9%, a level that is also slightly below year-ago levels. So whilst there is evidence of more cash flow difficulties amongst Auckland and Canterbury construction sector firms, these difficulties appear only slightly higher now than 12 months ago and are not widespread across the country.

FIGURE 5A, 5B & 5C

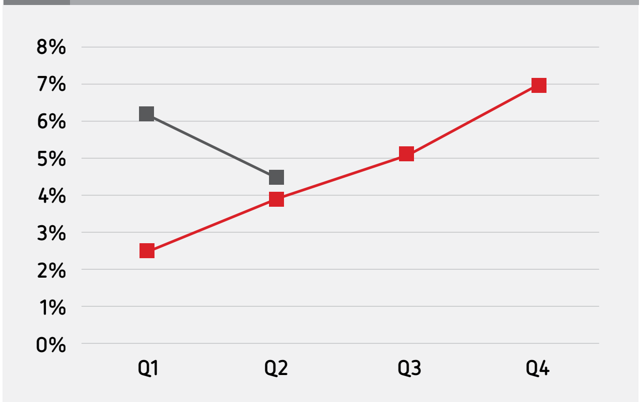
TRADE PAYMENTS OVERDUE BY 90 DAYS OR MORE AT THE END OF THE QUARTER FOR CONSTRUCTION FIRMS

5A Proportion of payments >90 days overdue, Construction sector in Auckland



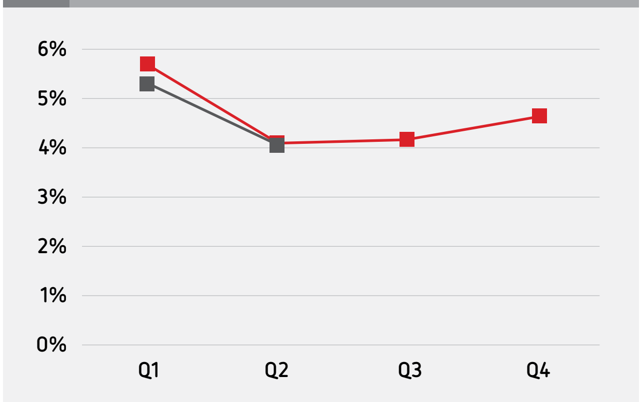
2015 2016 Source: Veda

5B Proportion of payments >90 days overdue, Construction sector in Canterbury



2015 2016 Source: Veda

5C Proportion of payments >90 days overdue, Construction sector in NZ ex AK/CANT



2015 2016 Source: Veda

CONSTRUCTION FIRMS ARE MANAGING HIGHER DEBT LEVELS, HOWEVER MONITORING IS REQUIRED

In summary, residential construction activity is forecast by the Reserve Bank to continue increasing due to the shortage of residential stock. This growth dynamic is exciting and generally positive for GDP but also creates pressure. A recent example highlighted is liquidation of building-related firms in Christchurch. As the companies are learning, it is not just project management of people and materials that is required but also management of cash that is important. The good news is that, in spite of some failures, the construction sector in general is managing reasonably well with their cash management.