MaxCap Group

NEW ZEALAND ECONOMIC AND COMMERCIAL REAL ESTATE UPDATE

DECEMBER 2020

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OVERVIEW

- The New Zealand economy has bounced back sharper than expected.
- Housing is a key part of that story, which is strongly supported by lower interest rates.
- This strength has driven a move to tighten loan-to-value ratio restrictions.
- The latest projections from the Reserve Bank are for house prices to rise ten percent over 2021 to 2023.
- Property market fundamentals remain mixed; interest rates continue to fall, but migration inflows (being a a big driver of demand) have slowed to a trickle.
- COVID-19 challenges remain with the economic impact of border restrictions yet to be felt.
- With New Zealand being largely COVID-19 free, it remains to be a big attraction provided this remains to be the case.

ACKNOWLEDGEMENTS

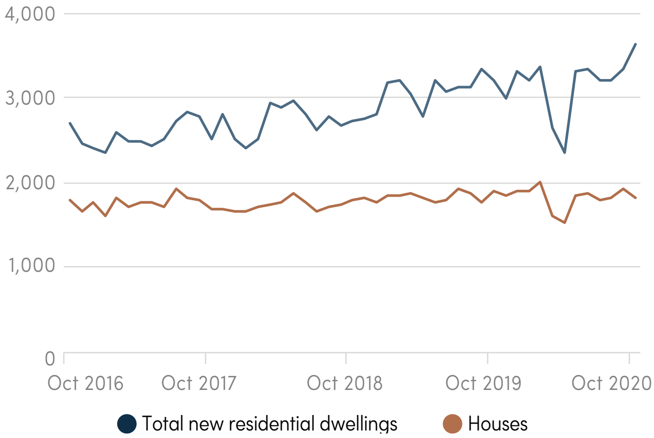
Data and information have been gathered from sources that MaxCap and Bagrie Economics believe to be reliable. This content does not constitute advice. This update was produced in collaboration with Bagrie Economics, New Zealand.

Unless otherwise stated, all amounts are in New Zealand dollars

MARKET COMPOSITION

- The estimated resident population is nearing 5.1 million.
- There are 1.9 million private dwellings, 65 percent of which are owner occupied.
- At present, there are 1.8 million households.
- Residential building consents issued in the past 12 months totalled 37,981 ($15.9 billion). 21,947 of these were houses, 3,557 were apartments and 10,633 were townhouses / flats.
- The monthly run rate for consents has remained more than 3,000 per month post COVID-19.
- Auckland accounts for around 40 percent of new dwelling consents.

TABLE 1: NEW DWELLINGS CONSENTED MONTHLY - SEASONALLY ADJUSTED



Source: Statistics NZ

THE ECONOMY – THE GOOD

Almost every economic indicator is coming in far better than expected. Unemployment has risen to 5.3 percent, which while up, is far lower than expectations six months ago. Jobseeker benefit numbers have flattened out. Money previously spent on offshore travel has been directed into the economy, which has mitigated the impact of a collapse in tourism visitors.

Dwelling consents remain strong and expansionary fiscal policy (government spending) is hitting the economy. The housing market has surged. Housing wealth has risen more than $100 billion in the past year.

The latest Reserve Bank (RBNZ) projections are for growth in real gross domestic product (GDP) of 2.3 percent per year for the coming three years.

Missed payments on loans fully secured by a residential mortgage (total loan exposure) is just over $2 billion, which is well under one percent total mortgage loans.

Stimulus in place to support the economy:

- Government $63 billon COVID-19 Relief Fund.
- Up to $100 Large Scale Asset Programme (LSAP) from the RBNZ.
- 0.25 percent Official Cash Rate.
- Funding for Lending Programme to lower bank funding costs and interest rates (estimated to be $28 billion).
- Mortgage deferral scheme until 31 March 2021.
- Nominal gross domestic product (June 2020 year) $308 billion.

THE ECONOMY – THE NOT SO GOOD

While COVID-19 challenges remain, the economic impact of border control is only just starting to be felt.

The tourism season is November to March, where typically 150,000-200,000 more offshore tourists are here relative to New Zealanders travelling overseas. During the winter months, more New Zealanders travel than offshore visitors arrive, so the shutdown was net positive the population over winter.

Commodity prices such as red meat prices have started to ease as discretionary spending is pared back around the globe, while dairy prices remain buoyant.

Though unemployment has risen far less than expected, the brunt is being felt in some segments (women), age groups (the young), and ethnic groups.

Migration inflows have slowed sharply. While annual net migration is 65,900, the monthly inflow since April 2020 is just over 400 despite picking up over August and September. Inflows are constrained by managed isolation capability. A recent survey by Kea found half of Kiwis living abroad were considering returning.

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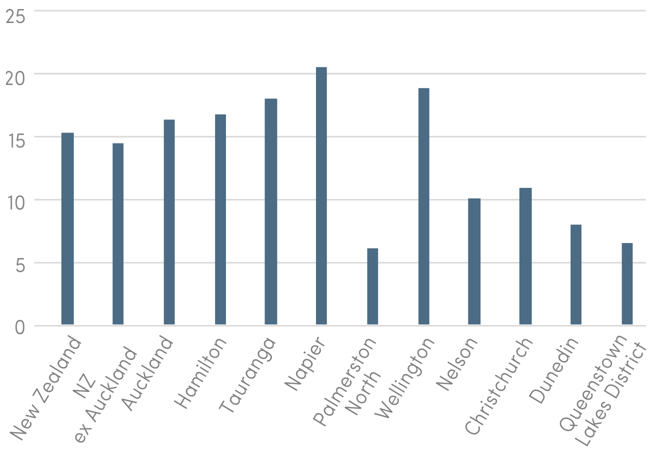
RESIDENTIAL HOUSING

The median house prices across New Zealand have risen 18.5 percent in the past year.

The Real Estate Institute of New Zealand's house price index is up 15.3 percent, and house prices are up 9.2 percent in the past three months.

TABLE 2: ANNUAL HOUSE PRICE GROWTH



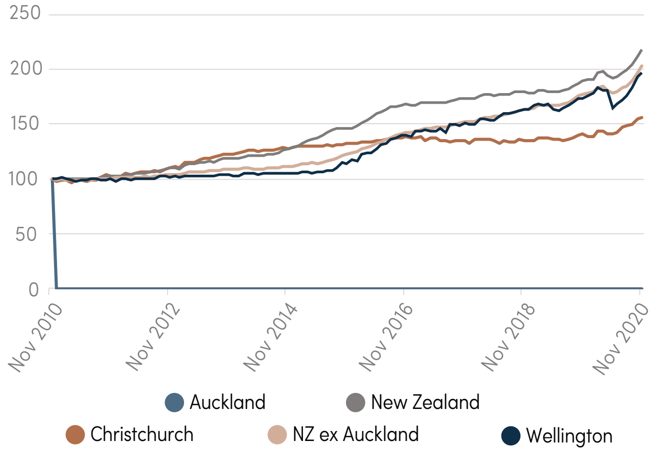
Source: REINZ

Market strength is evident across an array of measures. The average days to sell has fallen to 29, four days less than the same time last year, while volumes sold were 29.6 percent higher than a year ago. The number of properties sold in November were the highest in more than 13 years.

A key feature of the post uplift post COVID-19 has been the broadness across the country. Auckland has mirrored the national average.

The latest Monetary Policy Statement from the RBNZ projects house prices rising further over 2021-2023.

TABLE 3: HOUSE PRICE INDEX NOVEMBER 2010 = 100



Source: REINZ

We attribute the surge in house prices to three key factors:

- Record low interest rates. Residential mortgage rates are below three percent. Term deposit rates have fallen below one percent offering little yield and forcing people to look elsewhere.
- Structural undersupply of houses (see next page).
- New Zealand's relative outperformance, COVID-19 numbers, and attractiveness relative to other countries around the globe.

Surging house prices has seen two responses:

1. **Loan-to-value ratio restrictions**

   The RBNZ is starting to consult about re-instigating loan-to-value (LVR) restrictions on high-risk lending with effect from 1 March 2021. This will broadly involve owner occupiers needing a 20 percent deposit and investors 30 percent, with some runway allowed for each.

   The RBNZ removed LVR restrictions on 30 April 2020.

   Some banks have started to implement the policy already.

2. **The Minister of Finance has sent a letter to the RBNZ**

   This letter asks the RBNZ to expand its mandate to consider house price stability. While not encroaching on the independence of the RBNZ, it sends a clear message over the political sensitivity towards surging house prices and rising unaffordability.

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FUNDAMENTALS FOR THE HOUSING MARKET REMAIN MIXED

Dwelling consents have failed to keep pace with underlying population growth post the global financial crisis resulting in a supply shortage. A sharp decline in migration is expected to close this gap quickly.

Interest rates remain low and household debt servicing costs are at a record low. However, the ratio of house prices to income has risen above seven across the country and a 20 percent deposit on the median house is now more than two times average wage income which takes years to save.

Unemployment is also rising, but slowly. Considerable stimulus from both the government and RBNZ has contributed to a better economy and lower levels of unemployment than expected at the start of the year.

Unemployment is expected to peak around six percent over the coming year, which is up from 5.3 percent at present.

MARKET PIVOTS

The average square meterage of new dwellings has fallen from 200 in the early 2000's to 150 square metres in 2020.

Apartments, townhouses and units share of new builds has risen from 20-30 percent to be closer to 40 percent now.

STRUCTURAL UNDERSUPPLY

Population growth in New Zealand has been increasing at around 90,000 per year, spiking to more than 100,000 in the last year as people rushed home. Around 30,000 is natural population growth and the rest is migration.

Over the past four years, residential building consents have risen from 30,000 to 38,000 but have still struggled to keep up with population growth. Capacity has been a key issue across the construction sector.

Migration is now averaging less than 1,000 per month, which will bring population growth significantly lower over the coming year.

COMMERCIAL PROPERTY

Overall

Commercial activity continues to be underpinned by lower interest rates being weighed against economic prospects.

The spread between cap rates and the ten-year government bonds remains above five percent, a very solid premium.

The market is, however, becoming increasingly two tiered in terms of prime versus secondary stock. The yield on prime stock in particular has followed interest rates lower.

Overall vacancy rates are rising, most notably in Auckland. Quality stock in Wellington remains in short supply, driven by strengthening work removing stock. With government spending on the rise, Wellington will benefit as a defensive play on the economy.

COVID-19 has put downward pressure on supply in some sectors with many speculative development projects now on hold and downward pressure on rents is being observed. The dollar value of non-residential building consents has fallen from $7.6 in 2019 to $6.9 billion in 2020 (year ended October).

Retail

Retail is an underperformer, particularly in some central business districts as working from home takes hold. Large format retail (i.e. supermarkets) is bucking that trend with the latest retail sales figures showing sustained strength within the sector.

Industrial

Industrial is the outperformer with low vacancy rates and strong investment demand. A move towards the digital economy including more online shopping and additional distribution centres is expected to accelerate.

Office

Suburbs have benefited at the expense of central business districts and the Office sector.

The Office market is seeing rising demand for smaller floorplates. Large players are subletting space as more working from home takes effect.

As a result, refurbishment opportunities are expected to present themselves.

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Hotels

The hotel market continues to suffer due to border closure and the drop in international tourism, while some projects constructed pre-COVID-19 are still hitting the market.

INTEREST RATES

We expect interest rates to remain low for an extended period, as per the Reserve Bank of New Zealand's (RBNZ) guidance with the November Monetary Policy Statement, noting monetary policy will need to remain stimulatory for a long time.

The RBNZ remain some way off achieving their consumer price inflation and employment remit.

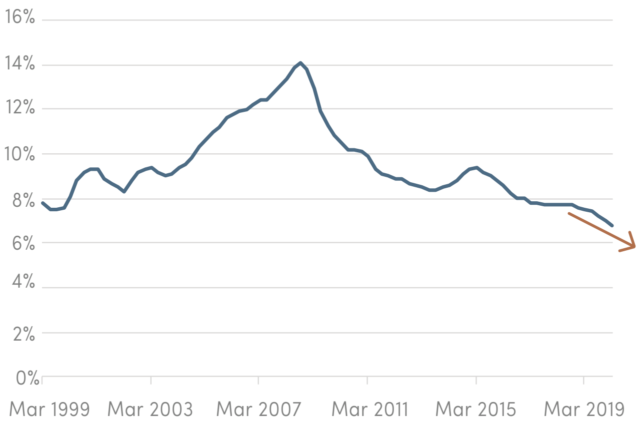
They stand ready to provide additional stimulus if necessary.

Market expectations are for the Official Cash Rate (OCR) to be zero (down from 0.25 percent now) by mid 2021. Markets have pared back expectations that the OCR could go negative due to the economy proving more resilient.

The RBNZ is also deploying a funding for lending programme (FLP) which provides cheap funding for banks. This is expected to lower borrowing rates.

The household debt servicing ratio (interest costs as a share of income) is the lowest it has been since 1999 and continues to decline. However, the ratio of house prices to incomes have now reached a multiple of seven. Auckland is approaching ten.

TABLE 4: HOUSEHOLD DEBT SERVICING AS A SHARE OF INCOME



Source: RBNZ

CREDIT

The latest credit conditions survey from the RBNZ reports high demand for residential mortgage loans. Banks have modestly tightened business lending standards. The banks own risk tolerance and perceptions of risks is constraining credit availability.

WHAT TO WATCH

Beyond the essential of remaining COVID-19 free, three key themes are topical:

- **The social tone.** Surging property prices are creating tension over the perceived benefits of monetary policy stimulus. The RBNZ has moved to put LVR restrictions back in place. The government has sent a letter to the RBNZ seeking more consideration of house prices. House prices will always be a consideration for the RBNZ, but the letter steps it up a gear.
- **Expectations on the government to deliver.** The government still have a large pool of money from the COVID-19 relief fund to allocate. Pressure to do more in the housing space, given affordability concerns, is intensifying.
- **Supply side challenges.** Border restrictions have removed a pool of labour. With each passing day, more anecdotes of difficulties finding workers are coming to the fore. This is both skilled and unskilled (i.e. picking fruit). Imports are almost ten percent down on a year ago, and while some of this reflects reduced demand, sourcing items is becoming an issue. Getting goods to market is becoming more challenging with supply chains around the globe facing difficulties. Capital and intermediate goods represent two-thirds of imported items into New Zealand.

FUN FACT : Around $150 billion of mortgage debt (roughly 50 percent of all mortgage debt) is due to refinance in the coming year. The weighted average interest rate on mortgage debt is around 3.6 percent, and one to five-year fixed borrowing rates across the major banks sit between 2.4 and 3 percent.

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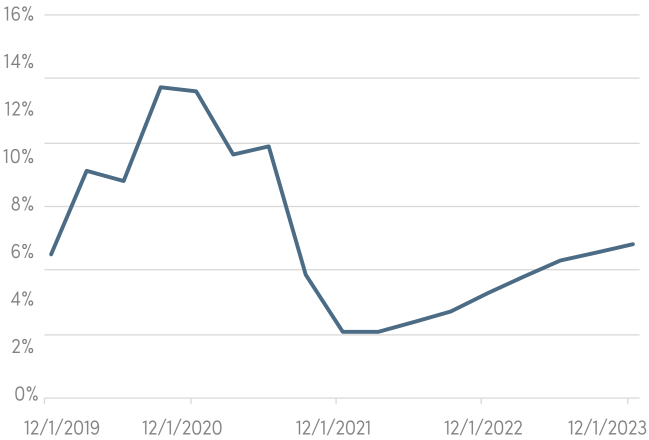
FORECASTS

- While the New Zealand economy has proven far more resilient than projected earlier in the year, risks from an uncertain global scene remain.
- Significant policy support for both the government and RBNZ is in place to support the economy, with prospects for more if economic prospects deteriorate.
- The latest forecasts from the RBNZ are for house prices to rise 10 percent over the coming three years.
- Economic growth is expected to average 2.5 percent over the coming three years.
- The unemployment rate is expected to peak slightly above six percent.
- Net government debt is rising, but remains low compared to international norms. It is currently just above 30 percent of GDP but expected to rise to slightly above 50 percent of GDP. The continued rise reflects ongoing support to the economy and time for the level of GDP (and tax take) to return to pre-COVID-19 levels.
- The NZD/USD is expected to remain elevated around 0.68 over the coming years, supported by NZ's economic position relative to the United States, and diminishing expectations the OCR will go negative in NZ. The outlook against the AUD is more mixed, with expectations of strength in the near-term (higher NZD/AUD), and softening over 2021 (source ANZ). New Zealand looks the economic outperformer in the near-term with unemployment peaking lower.

TABLE 5: HOUSE PRICE FORECASTS - ANNUAL PERCENT CHANGE



Source: RBNZ

SOURCES

RBNZ, REINZ, Bayleys, Statistics NZ, NZ Treasury, Bagrie Economics, Kea, ANZ.

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