TONY'S VIEW

Input to your Strategy for Adapting to Challenges

Feel free to pass on to friends and clients wanting independent economic commentary

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My Aim

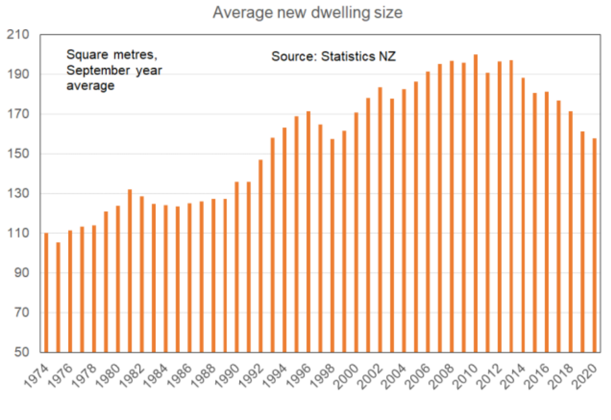
To help Kiwis make better decisions for their businesses, investments, home purchases, and people by writing about the economy in an easy-to-understand manner.

The Big Long-Term Changes Underway

There are quite a few things changing in New Zealand on a long-term trend basis which you need to be aware of when making your investment decisions. Here are a few of them gathered into one place.

Dwelling size is shrinking

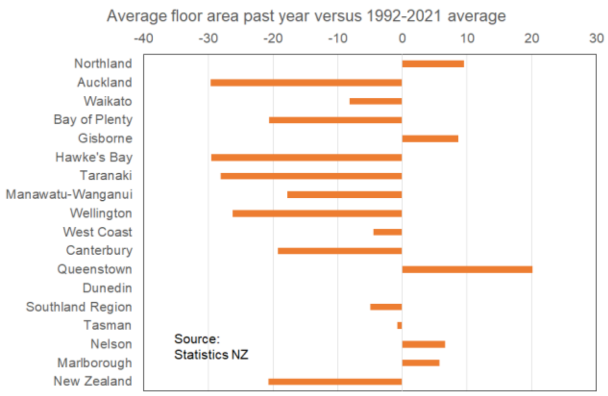
The following graph is based on September year average data, it ends in 2020, and it shows the average size of dwellings consented for each year. We can see that in the 1970s the average new house size was just over 110 square metres. In the 1990s it was 160 square metres, and in the 2000s almost 190. Now, the ten-year average has fallen to 180 square metres and the average for the past year has been just 156 square metres.



This reduction in dwelling size is going to contribute a lot to improved affordability of housing – as long as buyers don't aspire to owning the same size dwellings as people buying new ones from the mid-1990s up to three years ago.

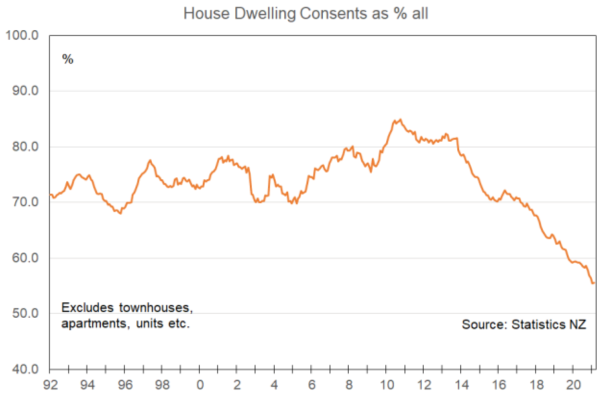
This following graph shows how the average dwelling size in the past year compares with the average since 1992 for all regions. The measure is square metres variance. I have taken out the Dunedin City result as there has been a blowout in average dwelling size which doesn't quite make sense.

What do you think the five regions showing increasing dwelling size all have in common? Maybe lifestyle, sun, retiring Bay Boomers, wealthier people escaping the cities.

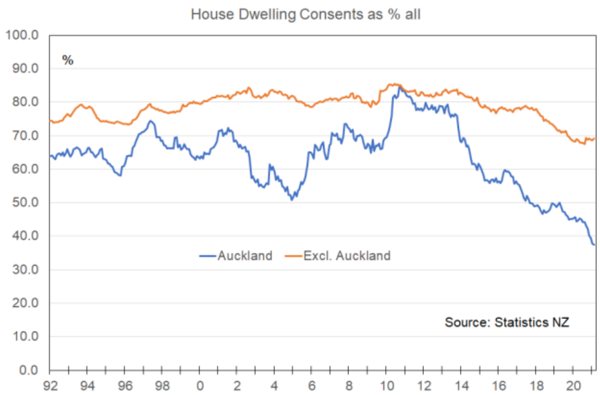


Dwelling type is changing

A key reason for the change in average floor area is that in most locations fewer houses are being built and more units are appearing – mainly as townhouses but also some apartments and retirement units. Nationwide, the proportion of dwellings built which are standalone dwellings has fallen to around 56% from over 80% ten years ago – as shown in the next graph.

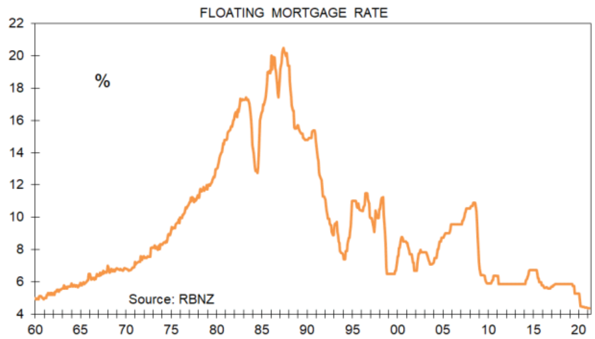


This change is most noticeable in Auckland where in the past year the proportion of dwelling consents which are for dwellings has fallen from around 78% to 37%. For the rest of New Zealand, the change has been from around 83% to 69%



Interest rates have stopped falling

Kiwis have known nothing other than downwardly trending interest rates since the peaks of the late-1980s. The following graph shows the way the floating mortgage rate rose for almost three decades, then fell for three decades. Guess which phase we are back into.



Will rates go back to old levels as they rise over the next three decades? That is very unlikely given the much higher debt loads for businesses, households, and governments now which mean when borrowing costs rise there will be a far greater reaction in spending and hiring decisions than before.

But the upshot of the trend plus the extraordinary circumstances of the global pandemic is that borrowers should not be factoring in any further cuts in interest rates and should instead be allowing for increases.

Population growth is slowing

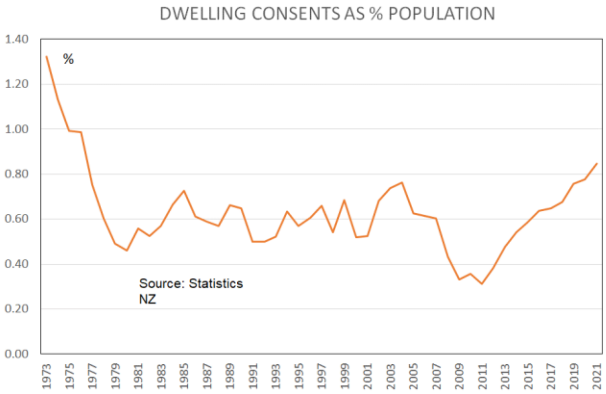
As noted here last week, New Zealand's population grew by 46% in the three decades ending in 2018. Statistics New Zealand project growth of 27% in the three decades following 2018.

This change arises from a rise in the mortality rate (Baby Boomers dying), plus a reduced fertility rate.

House supply is growing more rapidly

There has been a strong surge in the number of dwelling consents issued over the past decade. The annual number stands at 39,700 from around 13,500 in mid-2011. But the underlying level of activity is about 44,000 per annum if we annualise the last three or six months.

In the following graph we can see the annual number of consents issued as a percentage of the population. Supply growth is the strongest since 1976 and still rising with all stops being pulled out to boost house supply around the country and particularly in Auckland.



Rising house supply means greater ability to meet rising demand.

Risk of regulation of investors

The government has strongly shown that it is not prepared to leave it to the market to deliver the things which it wants in housing. It has regulated the quality standards which rented properties must meet. It has restricted the expenses which landlords can claim and taken away easy ability to dislodge tenants if desired.

It is now set on swooping over the top of the Reserve Bank to make it implement the government's housing policies not just with the fairly meaningless Remit change, but by telling the Reserve Bank which borrowers it can and cannot hit when it wants to influence the economy and financial sector risks.

Investing in residential property in New Zealand is now an activity subject to a high and growing level of regulatory interference. That does not mean the asset is to be avoided. It simply means that investors need to take this higher risk profile into account when they make and manage their purchase.

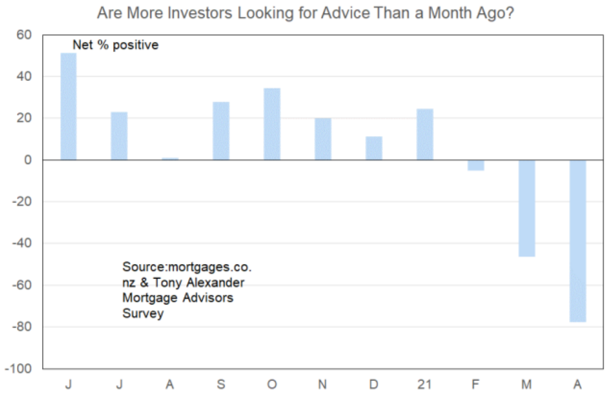
At its most basic level, the change in risk profile for residential property implies that investors seeking a diversified portfolio need to reweight slightly towards other assets.

TONY'S VIEW

New Zealand's Housing Markets

Mortgages.co.nz & Tony Alexander Mortgage Advisor Survey

On Tuesday morning I sent out the results from my latest survey of mortgage advisors and they show only one out of the 67 respondents felt that there had been a rise in investor enquiries over the past month. The rest either saw no change or felt there were fewer investors about (57 of the 67).



But enquiries from first home buyers were also down and this suggests that as yet we are not seeing the unusual phenomena when the nationwide lockdown ended in May last year.

Back then first home buyers hoping for listings immediately looked to take advantage of the removal of LVRs using some increased savings built up through seven weeks of enforced spending restraint. They jumped into the market and it wasn't long before the investors followed.

Will the first home buyers step forward in numbers again soon? This is the question which takes us to the heart of the carch-22 situation which young buyers unfortunately often allow themselves to get stuck in.

When the residential real estate market flattens out young buyers feel that time is on their side so they ease off in their feelings of FOMO and engage in what one might call a normal level of buyer demand.

But when there are concerns that prices might fall, they actively step back from buying out of fear that they will either experience negative equity should their deposit be small, or simply get poorer. That matters because as they are probably currently renting, they have a buy-versus-rent equation in their heads which other buyers do not have.

All it would take is a hint that rents might flatten out or ease and with the government making clear its desire to create "more sustainable" house prices, they could step back more than usual at exactly the time when they should be stepping forward to take advantage of the situation.

Is that what is likely to happen over the remainder of this year? Probably not because there is zero talk of rents falling and strengthened talk of rents rising as a result of the March 23 and other changes.

So, my view of the situation is that as long as house prices keep rising the first home buyers will increase their relative presence as 2021 progresses. That is a good thing – but if you're quick on the uptake you'll have just realised something.

I have a view that because of the frenzy of February and March as investors looked to buy before a 40% minimum deposit was required, we could easily see some price falls in average market measures soon.

When that happens, some young buyers will pull back from the market at exactly the wrong time if they want to take advantage of some likely improvement in the demand/supply equation.

I'll come back to discussing this situation if, and I believe when, we get a negative monthly house price movement soon.

Try and answer this question

House prices have boomed this past year not because construction has fallen or because population growth has boomed. Yet there is a near universal belief that there is a shortage of property all around the country. People are supposed to be cramming in on top of each other.

As we go through this year and 2022 keep asking yourself the following question. If the flood of investor demand dries up because of government policies, if we divert our spending back to overseas travel, if interest rates rise, and if FOMO disappears, will there still be a shortage?

Many of you know my answer, but figure it out for yourselves. There wasn't a physical shortage of toilet paper. But we scrambled for it and lobbied for more to be printed on the basis of us wanting to all of a sudden buy more of it than normal.

The same thing has happened with houses excepting that there is a shortage of social housing made obvious by people who previously lived on the streets, in sleepouts, and crowded into relative's houses, now living in motels since that opportunity to do so opened up a year ago.

Or try answering the question another way. When will we over-build houses? If you can't conceive of this happening, you may have a problem with your ten-year strategy.

Links to publications

Tony's View Spending Plans Survey

Tony's View Business Survey

Tony's View

Tony's Thoughts Vlog

REINZ & Tony Alexander Real Estate Survey

Oneroof weekly column

mortgages.co.nz & Tony Alexander Mortgage Advisors Survey

Tony Alexander Regional Property Report