FTMA
SUPPORT · INVEST · GROW

Vol 2. Ed.3 | June 2023

FTMA Trussted Insight

RISK AND RISK MANAGEMENT IN A DIFFICULT HOUSING MARKET

WITH TIM WOODS OF INDUSTRYEDGE

Risk and Risk Management in a Difficult Housing Market

From Tim Woods at IndustryEdge

This Trussted Insight episode focuses on some measures of risk in Australian housing markets – where the risks lie and how they are calculated and the implications for the supply chain, but especially for fabricators.

Risks in the Australian housing sector are rising. That is easy to say and few disagree.

There are plenty of indicators of the risks in the supply chain., but to get a handle on the whole situation, it is probably wise to start at the real beginning – householders or buyers.

Every shock jock, poor quality newspaper article and superficial television news report tells us something about the stress in the 'housing market'. Sometimes the reports are about the changing prices of established houses, other times about the housing construction sector, daily about loans and mortgages. It is confusing enough for the professionals to sift through it all and make sense of 'the market'.

How much more confusing for a humble householder, who continually hear stories of woe and little of comfort they can decipher, to help them decide what to do next, with their humble home?

Perceptions of risk start with buyers

We know the perception of risk, promoted and percolated by commentators, feeds into actual risk in the housing sector. The commentary becomes a key part of the feedback loop and when households act on the perception created by the evening news (by not getting invested in a new build, not trading up or failing to buy an investment property off the plan), it just confirms the original commentary.

This is an important place to start because there is no market without buyers.

There are buyers waiting on the edge of the housing market right now.

We know this because rental vacancies and affordability are both terrible right now. The influx of migrants to build the future will add to that demand, with careful management required to ensure that additional labour and housing supply are introduced simultaneously, so as not to make the problem worse.

So, why are buyers not rushing to the housing market, seeking to get their part of the national dream?

Here are a few reasons, and you will be able to think of more, add variants and have your own examples (and yes, some of these are contradictory):

- Employment insecurity makes it difficult for many households to get a loan
- Assembling a 10% deposit is hard enough, let alone a 20% deposit
- Interest rates are rising and predicting the cost of mortgage repayments is impossible
- Housing prices have been rising faster than wages
- It takes too long to build and time delays are cost and completion risks
- Views that housing prices are falling and could result in long-term negative equity
- Concern builder insolvencies (see below) will get worse and the housing dream becomes a nightmare

Ultimately, it boils down to this: households do not feel confident about the future.

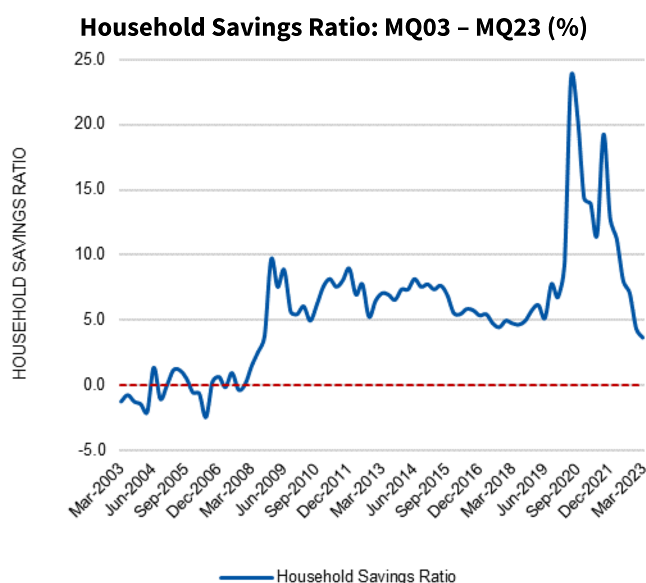
Little wonder really, when we look at some of the household level indicators.

Households don't feel well off right now…

Consumer and household sentiment surveys all point to a population that feels as though it is worse off now than for many years. Higher inflation and interest rate rises play a part in that. So do factors like the Household Savings Ratio. This is a national average measure of the savings held by households.

As we can see in the chart below, the HSR fell to 3.7% in the March quarter, its lowest level since 2008, in the midst of the GFC, and a dramatic rise and then plunge since the pandemic when we stopped spending.

Little wonder there is a lack of confidence, and we can thank the interest rate rises for much of the recent, spectacular decline in the savings ratio.



Source: ABS and IndustryEdge

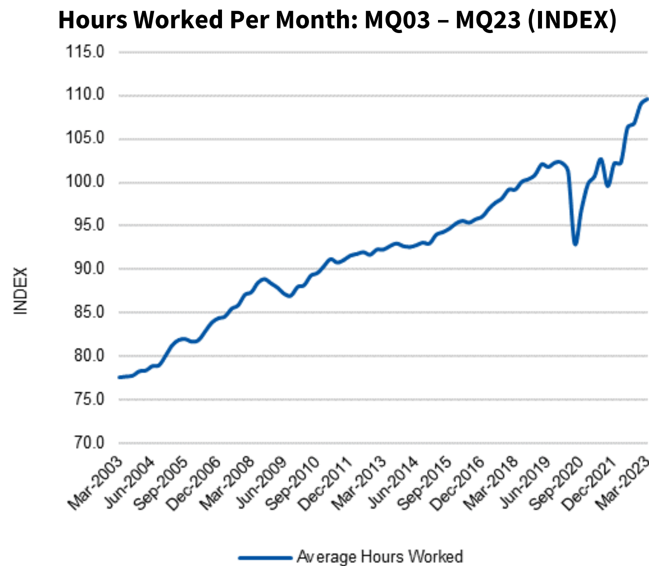
… but work and wages growth point to a bright future

Despite the understandable gloom, there are some pointers that households are going to be in good shape as soon as interest rates begin to moderate. The issue is timing when the moderation might occur. The latest inflation data shows prices have ceased rising. It will shortly be time to bring interest rates down and there is little to support further increases.

For households, that signal would be a welcome boost to confidence.

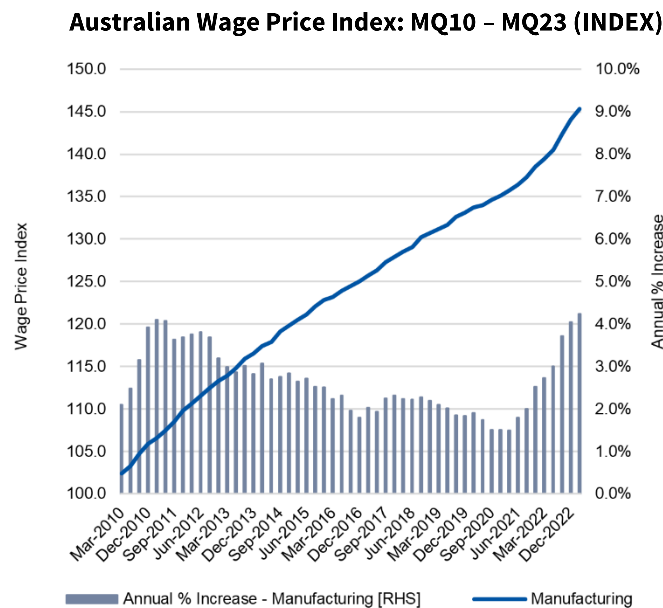
Meantime, with unemployment running at a very low 3.5% and the Participation Rate (those in work or actively seeking work) at a similarly high 66.8%, we can argue that pretty much everyone who wants a job, has a job.

Little wonder then, as a result, on average Australians worked a record number of hours in the March quarter. The index chart (next page) shows we have never worked more, and with low unemployment, there is little prospect of any type of steep fall.



Source: ABS and IndustryEdge

On another front that may add a little consumer confidence, after years of trending down, the Wage Price Index for Manufacturing shows wages are on the move. Year ended March, the average 4.2% increase in wages was the highest in fourteen years for the Manufacturing sectors. It is true that wages are still lagging behind the cost of living, but positive movements in wages will create future capacity for households.



Source: ABS and IndustryEdge

Overall, consumer confidence is dented at the moment. That, including uncertainty about the future direction of the economy, is flowing through into the housing sector.

It is the housing sector that may prove to be more troubling than households and consumers.

Intervention need also brings risk

Countries like Australia look to Government interventions in key markets – like new housing construction – to ensure the supply chain continues to track along adequately, meeting the national need. It is important for the Australian economy because housing makes up around twenty percent of the total.

Beyond 'the economy', issues like homelessness, rental availability and affordability are fundamental to the role of Government in helping all of us navigate society.

That means Government is heavily invested in the housing sector, in every sense. But, policy, program and even funding can end up being applied incorrectly, sometimes with devastating effect. The risk of Government getting its interventions wrong if not handled carefully is a driver for associations like the FTMA to be actively involved in lobbying, for instance.

Right now, the Government is fighting to get its expansive housing policies into play, allowing for money to flow from the middle of 2024, to provide additional social and affordable dwellings over the next five years.

The policy and literally $12 billion of funding to help make it happen are important for social policy reasons. It is also important because it is deliberately timed to come into operation right when the housing sector was likely to be at its bottom.

By mid-2024, we will need additional building work to quote, and work backed by Government helps reduce risks. But if politics causes the program to be beaten out of shape or to not proceed, well that's another risk for the housing supply chain, starting with builders, many of whom have not had a happy few years.

Builder insolvencies have lifted sharply

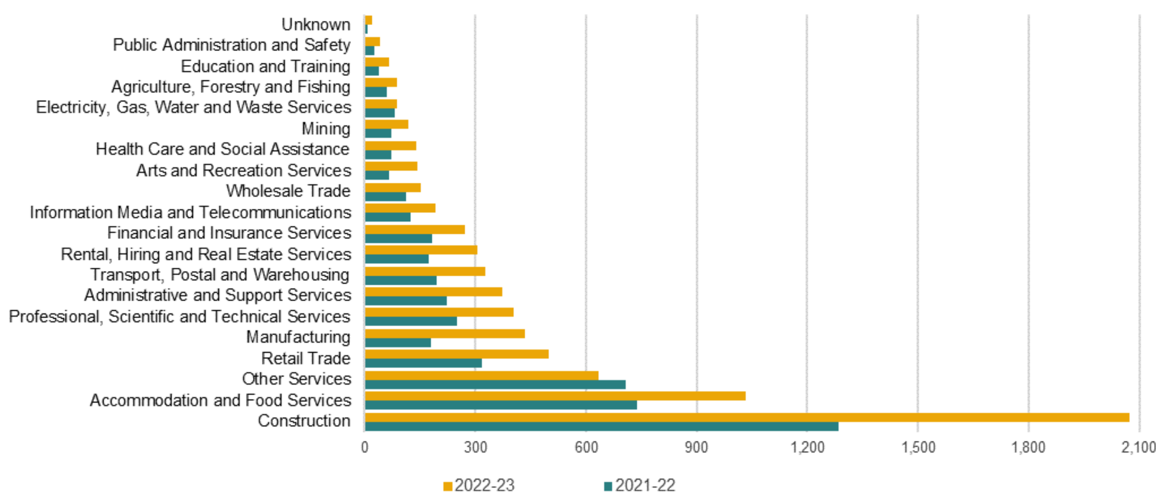
There has been a lot of discussion about the 'profitless boom', for the housing construction sector. The latest insolvency data tells us those concerns are well-founded!

The combination of plenty of work, but no available labour and fixed price building contracts, but constantly rising input prices, has not played out well for the housing construction sector.

As the chart below shows, the number of construction sector insolvencies exploded over this financial year, rising 61.5% on the previous year. The construction sector accounted for 28% of total national insolvencies over the last year. We all know there will be more.

Keep in mind that insolvencies are businesses that 'went broke', not just those who hung up the toolbelt and retired or simply went and got a job.

Australian Insolvencies: 2021-22 v 2022-23 (Number)



Source: ASIC and IndustryEdge

For those interested in where the construction sector insolvencies are occurring, the table below will be of interest. Those interested in exploring this data further can go to [ASIC's website and download the file](#).

It is hard to bypass the situation in NSW. It appears building and construction activity in that state is under real pressure, probably much of it cost based.

Australian Construction Industry Insolvencies by Region: 2022-23 (%)

	Proportion
ACT	1.9%
NSW	43.6%
NT	0.2%
QLD	17.5%
SA	2.6%
TAS	0.2%
VIC	27.7%
WA	6.4%

Source: ASIC and IndustryEdge

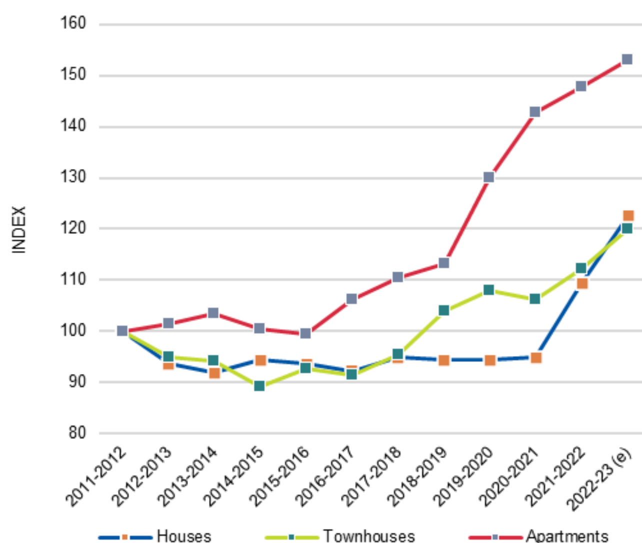
Ultimately, what the insolvency data reminds the market is there are always significant risks in the housing construction sector. One of those that is little understood, or at least is ignored as being too hard to manage, is the impact of time. The 'time value of money' is critical to the profitability of businesses.

'Time to build' is a major cost problem for house builders

For many years, the time it took to build a single house hovered around the six months or 180 day mark. That was different to the situation with apartments first and then a little later, townhouses. As the chart below shows, over the last decade, the time it took to build townhouses and apartments began to expand – quite dramatically as it turns out.

Many argued that was a result of inefficient approvals and building processes. Perhaps that was right, in part. What was also true was that apartment blocks included in the same timetable grew on average. Then, the groups of townhouses that were being built expanded in number. The reason was that doing a larger group of either apartments or townhouses was more efficient per dwelling, even if it took longer overall to get the job finalised.

Average Time to Build by Format: 2011-12 – 2022-23 (e) (Index)



Source: ABS and IndustryEdge

It was only from 2020-21 that the time to build a house began to push out, to the point where instead of taking six months to build, it is currently taking close to nine months! The difference is that for houses, there are no ‘bulk efficiencies’ and each house stands alone from the builder’s perspective.

The value sapping delays in building houses have hit builders very hard – insufficient labour, reorganising work schedules, rework for damage and theft, delays in being paid, higher interest payments on the overdraft and uncertain but rising materials costs, and so on.

Costs associated with time, inefficiencies and a lack of profit in house building will probably change the nature of the industry forever, over the next few years. We will discuss this further in the next edition of Trussted Insight.

Right now though, what it all means is risks have increased significantly, as fabricators well know.

A production slot that a builder ultimately doesn’t confirm, an order cancelled, work delayed, are all costs to fabricators, not just to builders. It is not clear that all fabricators take these risks and their costs into account when quoting jobs.

Risks, insurance and cover tightening

There is no sector of the economy more attuned to risk than insurers. Their role is to measure and place a monetary value on risk and provide – for a fee – cover for particular risks. Fabricators, for the most part, know this is the case because they carry insurance on their portfolio of work and their roster of clients.

As the risk of client (builder) default has increased, the risks for their suppliers (in this case, fabricators) has also increased. Insurers have increased their premiums to cover those risks.

Fabricators are aware of those changes, but since at least the start of 2023, insurers have reportedly been managing the specific portfolio and client roster of fabricators.

This has involved immediate reductions to the total value of insurance cover that might be available for a particular builder – we hear some are at 50% of previous limits – or a limit on the proportion of a fabricator’s total portfolio that any one builder can represent.

Here are two examples.

Example One

A fabricator has $10 million of insured work with a builder at any one time in March. In April, they are advised that must fall to $5 million. The fabricator reduces the portfolio of work by ceasing to bid for any work with the builder until they have ‘room’ in their cover limit.

Example Two

A builder represents 25% of a fabricator’s portfolio of work. The fabricator’s insurer requires the builder to be less than 20% of the total and no more than $5 million of covered work. The fabricator has to reduce their exposure to the builder and needs to pursue other work to cover the lost business activity.

Overall, the consequence of this situation has seen fabricators:

- Diversify away from a core client (builder) because of the reduced cover;
- Reject work because it would be in excess of or outside their insurance cover;
- Take the risk and do work for which they have no insurance.

Not all fabricators are in the same situation. Some have opportunities to self insure and some have direct relationships (joint ownership) of builders for whom they work.

For the majority however, the risks in the housing sector and the response of the insurers is making business conditions more difficult, adding to the risks of being in the sector.

Risks without rewards – is that where we are at right now?

The Australian housing supply chain is full of risks. Some of those can be insured, at least some of the time, as we have discussed. Other risks though are a normal part of life – business life at least.

Without risks, there are often no rewards. That is why the supply chain is full of entrepreneurs who take the risk to invest capital and engage in manufacturing, supplying, installing, and so on, a wide range of building products, including frames and trusses.

The major concern for the supply chain right now might be to avoid taking on all the risks of other points in the supply chain – like builders – or for those whose specific and well remunerated job is to take on those risks – like insurers.

It is difficult enough that fabricators – along with the whole supply chain – are obliged to take on the risks associated with households and their perceptions.

Contact IndustryEdge

+61 3 5229 2470

info@industryedge.com.au

www.industryedge.com.au

Contact Tim Woods directly

+61 419 352 869

tim@industryedge.com.au