Vol 2. Ed.5 | November 2023

FTMA
Trussted Insight

LOOKING BEYOND THE 'PUNT'

WITH TIM WOODS OF INDUSTRYEDGE

Looking 'beyond the punt'

How the housing market is changing and why those changes are a better bet than a day at the races

From Tim Woods at IndustryEdge

As you read this edition of Trussted Insight, the Spring Racing Carnival will have finished for 2023, with this text being written on Melbourne Cup Day. More importantly for the future shape of the economy and the housing market, in particular, today is 'interest rate decision day'.

My bet, for what it is worth, is that later today, the RBA will increase the interest rate by 0.25% to 4.35%. By the time you read this, you will know if that's the case and that will inform your thinking.

There is one key question in the Australian economy right now.

What will 2024 be like?

There are very few business leaders and owners not considering this question. We all seek to understand the conditions that will prevail in the year ahead. Partly, that is because we want to be optimistic, but increasingly, it is because we are engaged in planning for that future.

Everyone wants to know and there are plenty of views. Before expressing a view of sorts, here is some data we would encourage fabricators and others to consider. This is a more detailed examination of employment data and what implications it might have for businesses over the next year.

All too often, the conversations on labour are narrow and immediate, but it's a super-important factor that needs to inform our decision-making.

Employment data points to first signs of softness

Australia is labouring (pun intended) under the weight of an economy that for a year or more has seen near enough to full employment.

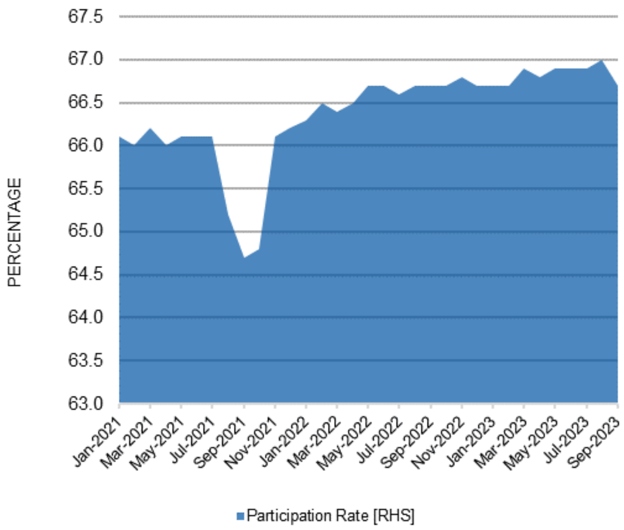
Some argue that with the unemployment rate stubbornly below 4% for nineteen consecutive months – and at 3.6% in September 2023 – that the definition of 'full employment' needs to be rewritten. Probably true, but for our purposes, we just need to know it has been very difficult to attract labour, especially workers with the skills required, for all this period.

In the latest round of FATSO[1] interviews, we were advised by several fabricators that hiring had become a little easier in recent months, there were a few more candidates and so on. That seems to be borne out by the first employment data in some time to point to the edges of the labour market becoming a bit fragmented.

The first chart (following page) shows the 'Participation Rate', which measures the proportion of people of working age either in work or looking for work. In September, it dipped to 66.7%, the lowest since February. A small sign perhaps that some people have stopped looking for work?

[1] Frame & Truss Sector Outlook, interviews conducted September 2023

Australian Employment Participation Rate: Jan '21 – Sep '23 (%)



Source: ABS

A drop in the Participation Rate doesn't mean unemployment has increased. It often means some people have stopped looking for work. That will usually be because the labour market has tightened for them, so its typically people who are 'marginal' in employment, like those with less skills or who have a range of other responsibilities, like home duties, around which work must fit.

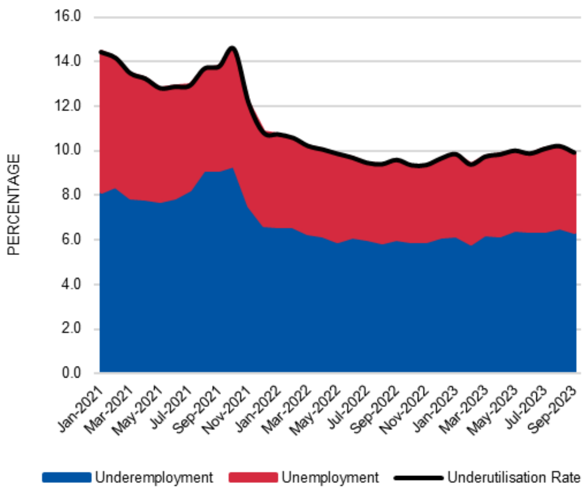
Our working assumption is that there are just a few less jobs and less employer desperation and flexibility than was the case a few months ago.

The Unemployment rate, shown below with the Underemployment rate (those with work but who would like more hours), together make up the black line of the Labour Underutilisation rate. The Labour Underutilisation rate was 9.9% in September, so in theory the economy is wasting about 10% of its productive labour force capacity.

However, along with the Participation Rate, the Underutilisation Rate fell in September. This is the first symmetry between the two for some time.

Though the Labour Underutilisation rate was lower in mid-2022 than it is now, it has only fallen lower now because the Participation Rate has fallen. This seems to back the conclusion there are less jobs available.

Unemployment, Underemployment & Labour Underutilisation: Jan '21 – Sep '23 (%)



Source: ABS and IndustryEdge

Who are the people whose job opportunities are perhaps decoupling from the general experience of full employment?

The data tells us that mostly, its young people. In September, people aged 15 to 19 were greater than three times more likely to be unemployed than the average, with their rate sitting at 11.3% (compared with 3.6%). For those aged 15 to 24, the unemployment rate was a still hefty 8.0%.

Just as interesting is the 17.1% lift from September 2022 to September 2023 in the number of people aged 15 to 24 who are underemployed and therefore need or want more hours. That growth was triple the average for all employees also.

This tells us that those who are usually most marginal in employment are starting to feel the chill winds of a changing employment outlook. It is routinely they who are first in the economy's line for stiff breezes, and who sadly, often have the thinnest coats. Doesn't bode well if we want to sell them a house anytime soon!

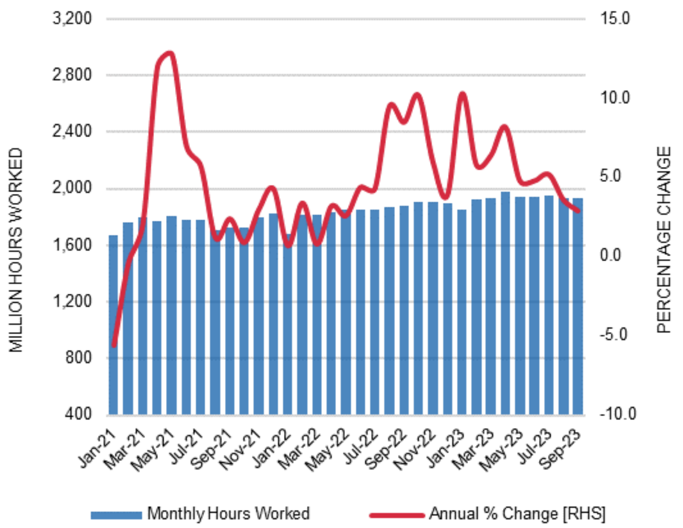
It might however be that 2024 will be a good time to seek apprentices and trainees who can become embedded into stable businesses.

Average hours worked are falling

In September, Australians worked 1.930 billion hours, the second successive monthly decline, despite their being a record number of people in work, recorded at 14.115 million. The average monthly hours worked fell to 136.7 hours, down 0.3 hours on the prior month.[2]

At the same time, the annual change in hours worked continues to retreat. Compared to the year-ended September 2022, the most recent year saw growth in hours worked fall to a small but retreating rise of 2.9% as the red line below shows.

Monthly Hours Worked and Annual Change: Jan '21 – Sep '23 (Million Hours & %)



Source: ABS and IndustryEdge

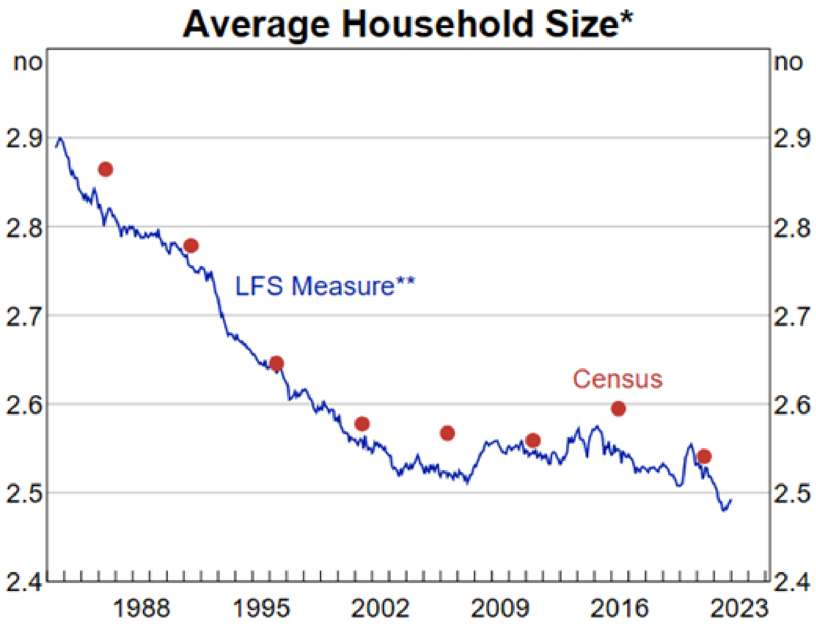
The summation is that the employment data tells us there is a softening underway. We can anticipate that by mid-2024, the unemployment rate will be rising and our use of labour will be a little less efficient than it has been in recent times.

What does that mean for the housing economy?

[2] Note that here we have used the entire employed cohort in the Australian economy, not the narrower definitions often used for per capita assessments

More and smaller dwellings – a long time coming

One fact that now seems uncontroversial – but which has far-reaching consequences – is that Australia's average household has declined in size to be around 2.5 people per dwelling. Many of us are familiar with the chart below which suggests average household sizes are continuing to decline.



* Average number of persons usually resident in an occupied private dwelling; excludes visitors and persons in non-private dwellings (e.g. hotels and hospitals).

** Estimated using Labour Force Survey microdata; seasonally adjusted.

Sources: ABS; RBA

The implication of smaller household sizes for a growing population is that Australia will need more dwellings in future, and they will be smaller than in the past.

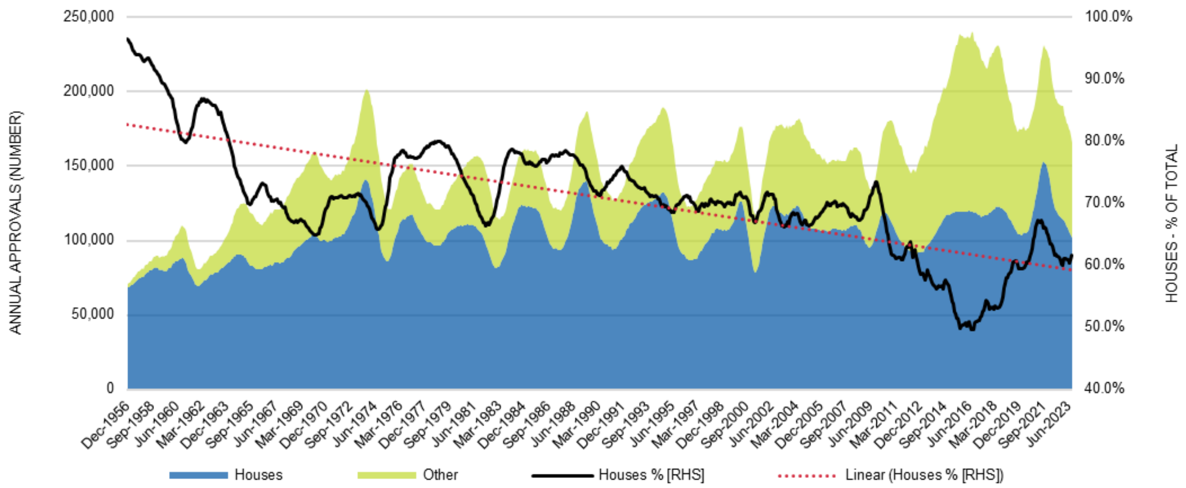
If we couple those observations with high land prices, constraints on infrastructure driving increased residential density in and around cities and the still growing cost of new dwellings, we can predict Australia will see an increased move toward multi-residential dwellings.

Add to that the emphasis of the Housing Australia Future Fund on social and affordable housing and you get a further impetus and driver toward increased supply of smaller dwellings that are more likely to be in multi-residential formats.

This should come as no surprise because give or take a few historic blips, the market has been headed that way since the end of the Melbourne Olympics in 1956. The chart on the following page shows annualised Australian residential dwelling approvals for the last almost seventy years, but shows Houses compared with all other formats combined.

It is the black line and the dotted red line that should occupy our attention because they plot the very long trend of deterioration in the proportion of Australia's new dwellings that are made up of free-standing houses. In 1956, Houses accounted for 96.5% of all approvals. Year-ended September 2023, that was down to 61.7%, having fallen to a low of 49.7% year-ended September 2016.

Australian Annualised Dwelling Approvals: Houses v Other: YE Dec '56 – YE Sep '23 (Number & %)



Source: ABS and IndustryEdge

Considering the trend – against which I would not be prepared to bet even a speculative fiver – the recent experience with a spike in Houses relative to other formats over the pandemic years is an outlier event and not a 'return to normal'. As we commented many moons ago, that came about solely because there was 'too much money, given to too many people, for too long'. We are not likely to see the likes of that public policy endeavour again.

Rather than focus on the booms and busts evident in the data, take a line through from September 2002 and House approvals have barely lifted and have averaged 112,600 approvals per year. The other formats have increased about 30% on 2002 levels and averaged 70,500 approvals per year.

The data **does not** tell us that the days of Houses are finished and we will not see them being built in our suburbs in the future.

The data **does** tell us that future booms – including whatever outcome is achieved toward the ambitious and much vaunted goal of 1.2 million new dwellings over the five years from mid-2024 – will be driven by multi-residential formats, more than by free-standing houses.

Builders and investors migrating to multi-residential formats

We noticed in its announcements it was back into profitable territory that the Simonds Group reported it anticipated weaker demand for the greenfield housing projects that have been its bread and butter since the early 1950s. Moreover, it reported it was stepping up its role in the medium-density townhouse sector where demand was stronger, something it has not done since it listed in 2016.

The Simonds Group is not exiting free-standing houses, but like others pursuing volume and margin, they are shifting away from a solely greenfield development focus.

Though they did not say so, Simonds and others like them are acutely aware that even though it may be fragmenting at the edges, the core labour market is under-supplied. For skilled labour it is very under-supplied and on-site, is also relatively expensive.

Reduced exposure to onsite labour shortages, delays and costs helps builders improve margins. For some, that underpins their approach to pursuing more standardised and controllable housing formats, like multi-residential properties.

Whatever form the investors come in – Government, institutions, wealthier households – the emphasis will be on efficiency of land use and building processes. In particular, those ‘building to rent’ will be focussed on any means they can to reduce their up-front costs as they seek to recoup their investments over the shortest possible timeframe.

The role of investors of this type will be incredibly important, in part because those younger people we started out considering – those with precarious work (not enough hours), relatively poorly paid, more likely to be unemployed and soon enough, likely to be facing a tougher labour market – are going to be renting for a long time into the future.

For most investors, the multi-residential formats will be in mind, for their tenants of the future, because that is where the best returns will likely reside.

Perhaps we’ll take it each way, but we can bet on this…

The bets we make on the horses should be proportionate to our capacity and appetite for risk and should be informed by the best possible information. The same applies to our businesses.

Right now, the information is pointing toward the Australian housing economy entering a new and more stable phase, with two major changes possible over the coming year.

First, it is possible the long-anticipated shift to multi-residential properties dominating over free-standing houses could become reality.

Second, it is also possible that unemployment might begin to rise, dampening some of the demand for new dwellings and reducing capacity of some households to pay for their accommodation.

On that final point though, one fact on which we may rely is that a growing population will need more dwellings.

It is what type they will be, who will own them and how they will be built that is more at question.

Where’s the IndustryEdge bet this Melbourne Cup Day? On growth in multi-residential dwelling formats, and on a larger role for investors of all types (governments, institutions and well-healed Australians) over the next five years.

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