The Treasury

Material Provided to the Public Inquiry into EQC Information Release

August 2021

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[31] 9(2)(f)(ii) - to maintain the current constitutional conventions protecting collective and individual ministerial responsibility

[33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

[35] 9(2)(g)(ii) - to maintain the effective conduct of public affairs through protecting ministers, members of government organisations, officers and employees from improper pressure or harassment;

[36] 9(2)(h) - to maintain legal professional privilege

[37] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice

[38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice

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THE TREASURY
Kaitohutohu Kaupapa Rawa

Date: 3 June 2014

To: Minister of Finance
(Hon Bill English)

Associate Minister of Finance
(Hon Steven Joyce)

Associate Minister of Finance
(Hon Dr Jonathan Coleman)

Deadline: None

Aide Memoire: Update on the Canterbury rebuild

The attached annex of this aide memoire provides an update on the Canterbury earthquake rebuild and is provided for your information. The material presented in it has largely been provided by CERA, but the interpretation represents Treasury's assessment of the most likely future progress of the rebuild for the purposes of the economic forecasts in the *Budget Economic and Fiscal Update* (BEFU).

The report provides more detail than was included in the BEFU, but is consistent with the outlook for the rebuild and the economy presented there. The material presented in this report may also be used in the Pre-election Economic and Fiscal Update.

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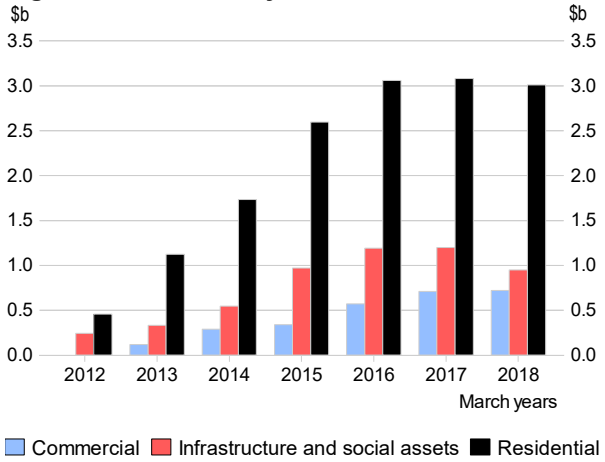
Annex: Update on the Canterbury Rebuild

The Canterbury rebuild is set to provide a major stimulus to the economy with both the private and public sector playing their part. High levels of construction activity have been observed in the region to date, while steady progress continues to be made on insurance settlements for residential and commercial claims. However, there is still some uncertainty surrounding the timing and magnitude of the rebuild over the forecast period owing to the complexity involved with the insurance claims outstanding and the evolution of resource pressures. The rebuild is a significant factor in the outlook for the New Zealand economy. This topic provides more detail on the assumptions which underpinned our recent Budget 2014 forecasts and provides an update on progress so far.[1]

Figure 1 – Canterbury-related investment



Source: The Treasury

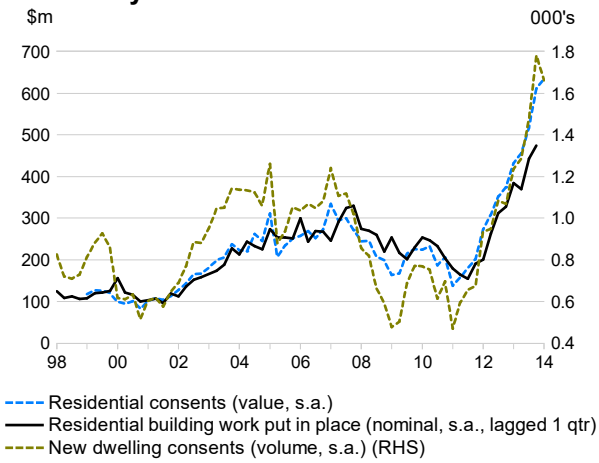
Rebuild a major feature of growth…

The Canterbury rebuild will provide a significant impetus to demand over the forecast horizon, chiefly through investment in residential infrastructure and social assets. The Treasury's estimate of the total amount of rebuild investment is $40 billion, with around half of this total assumed to take place by mid-2018. In the *Budget 2014* forecasts, Canterbury rebuild-related investment is expected to peak in the March 2017 year. Residential investment is expected to provide the greatest contribution over the forecast period, followed by investment in infrastructure and social assets, and commercial assets (Figure 1).

…led by residential construction…

Construction data indicate that residential activity in the region has picked up strongly over the past year. The value of residential building work put in place in Canterbury has risen by $320m from the trough immediately after the February 2011 earthquake to $474m in the December 2013 quarter, about 44% above the previous peak in 2007 (Figure 2). The number and value of building consents is on a strong upward trend, indicating a continuing pick-up in construction activity ahead. At the same time, the processing time for both resource and building consents has continued to improve. Although these regional building activity measures are a useful proxy for the scale of activity thus far, they do not fully distinguish between earthquake-related and business-as-usual activity and also exclude small-scale repair work which does not require a building consent.

Figure 2 – Residential building work in Canterbury



Source: Statistics NZ

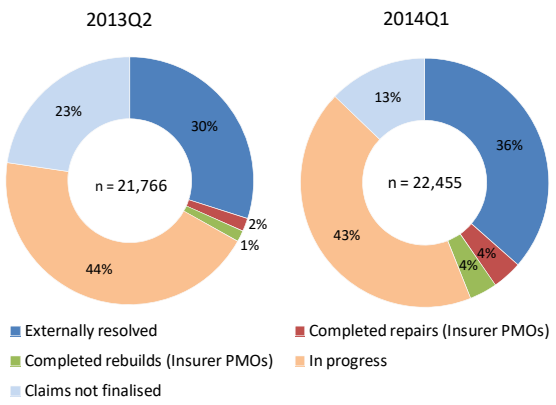
…as the resolution of claims progresses…

Data on dwelling claim resolutions provide a more direct measure of overall progress for the residential rebuild. As of 1 April 2014, around 70% of the 171,000 residential dwelling claims had been settled. Private insurers have settled 44% of the 22,000 "over-cap" claims, while EQC and private insurers have settled 73% of the 149,000

[1] This topic draws on material provided by CERA but the interpretation represents the Treasury's view.

"under-cap" claims.[2] The majority of over-cap claims settled to date (about 80%) have been resolved outside of the insurer Programme Management Offices (PMOs) and largely involve a cash settlement as opposed to a customer-managed repair or rebuild (Figure 3).[3]

Figure 3 – Resolution of over-cap claims[4]



Source: CERA

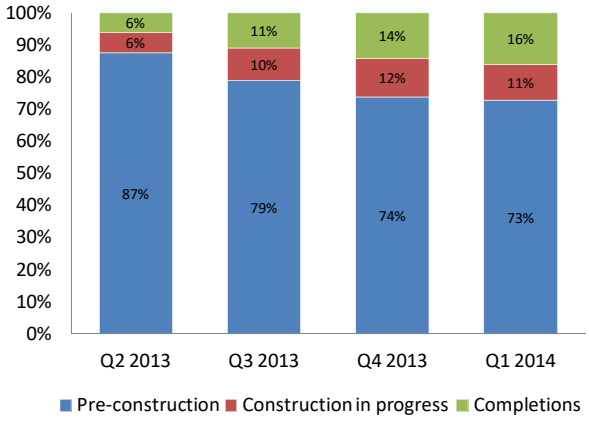
There are ongoing issues around outstanding insurance claims, particularly for claims which involve land damage and shared properties, and this will likely contribute to ongoing volatility in the pace of settlements. This will continue to add uncertainty for firms involved with the rebuild, which will affect their willingness to take on more permanent staff and to increase their investment.

…but recent pace of completions has slowed

PMOs are expected to manage around half of the 22,000 over-cap claims and are currently 16% of the way through their pipeline of over-cap repairs and rebuilds (Figure 4). After a solid pace of completions of around 400 per quarter in mid-2013, the rate of completions slowed in the following three quarters to around 260 by the March 2014 quarter, well short of the PMOs' earlier forecasts. It appears that much of the delay is concentrated in the pre-design and design/documentation stage owing to technical/legal issues around foundations and retaining walls, as well as customer indecision and disputes.

Of the over-cap claims being resolved externally, the progress of customer-managed over-cap repairs and rebuilds (estimated to be around 1,200) are difficult to track, but it is assumed that they are progressing at around the same pace as those managed by PMOs. Cash settlements and housing reinstatements (through the purchase of a new home) for over-cap claims, on the other hand, do not initially lead to fixed capital formation. However, these types of resolutions will still add to housing demand, which may trigger investment either in future periods or elsewhere in the country.

Figure 4 – Progress of PMO-managed repairs and rebuilds



Source: CERA

The uneven profile of over-cap repairs and rebuilds is expected to continue given the ongoing complexities around claim resolutions and unforeseen bottlenecks in the construction process. However, unless the current tempo of reconstruction work by PMOs accelerates, the current pipeline of over-cap rebuilds and repairs will not be resolved by the December 2017 target set by private insurers. The Treasury's forecasts, which allow for supply constraints, assume that the total residential rebuild (including customer-managed reconstruction work) is likely to be completed several years beyond December 2017. At a high level, annualised consent issuance for new dwellings will need to continue at around 6,000 for the next 3-4 years in order to rebuild the 22,000 severely damaged homes as well as to meet underlying housing demand. Meanwhile,

[2] "Under-cap" refers to a claim where the overall cost of repair and replacement is less than the $100,000 threshold that EQC covers per event. Homeowners who are under-cap work with EQC to resolve their claim while homeowners with claims that are over-cap work with their private insurers.

[3] The settlement rate of externally resolved claims is significantly higher than claims subject to an insurer/PMO-managed repair/rebuild given that external resolutions are a straightforward transaction once approved.

[4] Claims in progress mainly relate to those that have been transferred to the PMOs but work has not yet been completed.

under-cap claims will begin to wind down over this year and are broadly on track to be completed by EQC at the end of 2014.

Government projects to step up...

The horizontal infrastructure programme (HIP), which aims to restore network services to pre-quake levels, has continued to progress with sewerage, storm- and drinking-water networks largely restored. The programme is within budget with around a $1 billion of Crown funding spent so far (out of a total of $1.8 billion budgeted) and a projected completion date of December 2016. The rebuild of all public and private infrastructure (estimated to be about $4.5b) is assumed to be largely completed within the Treasury's forecast period, i.e., by mid-2018.

In addition to the infrastructure rebuild, the Government has committed funds to the rebuild of and investment in social assets such as hospitals, educational institutions and anchor projects in the central city. Some of these projects are still in their early stages (e.g., the Justice Precinct) and the purchase of land for others is currently underway. The projects are expected to gain more traction in the second half of this year, but the pace going forward will be influenced by the ability of government agencies to effectively manage large projects in a capacity-constrained environment.

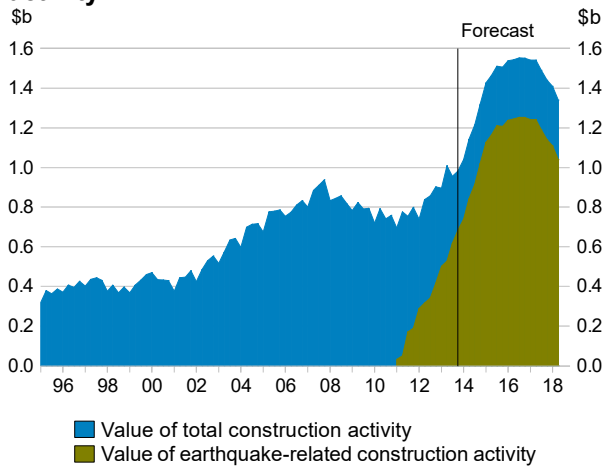
...while private investment is less certain

At the end of February 2014, around $7.3 billion of commercial insurance claims had been settled, which represents approximately three-quarters of all commercial claims. Estimating how much and where this insurance money is being invested by the private sector is difficult because of a lack of data. It is evident that most of the private sector capital investment to date has occurred in parts of the city outside of the core CBD (e.g., to the west of the city centre, Victoria Street and Addington).

Resource pressures to intensify further...

Our forecasts take into account the capacity of Canterbury and allowed for a considerable shift of construction resources into the region. The level of total construction activity is currently estimated to be close to or above the peak achieved during the mid-2000s housing boom, which suggests that resource pressures are likely to intensify further in the future (Figure 5).

Figure 5 – Canterbury nominal construction activity



Sources: Statistics NZ, Treasury

If the pace and level of the Canterbury rebuild is slower, there will be less displacement of activity in the rest of the country and less competition for construction resources, resulting in less upward pressure on prices and wages. Improvements in productivity that reduce the amount of resources required would have a similar effect. There is also a risk that competing demand elsewhere, especially in Auckland, is greater than assumed, which would limit the transfer of resources to Canterbury.

We have already seen the demand in Canterbury draw construction resources from elsewhere in the economy. Nationally the total number of jobs in the construction sector in the March 2014 quarter has just recovered to its pre-recession peak, but in Canterbury they are currently around 60% higher.[5] For the labour market as a whole in Canterbury, there are fewer additional workers available, with the unemployment rate currently at a low 3.3% (2.6% for males).

...as cost pressures remain

Business surveys such as the NZIER QSBO suggest that labour is still difficult to find, although wage and building cost inflation are higher than in the rest of New Zealand, suggesting that price pressures are yet to spill over significantly. The Labour Cost Index (LCI) showed that salary and wage rates (including overtime) for the construction sector rose 3.0% in Canterbury in the

[5] The experimental Canterbury construction filled job indicator is estimated off tax data and Statistics NZ's business register. It is experimental and not subject to the same robustness tests as Statistics NZ official statistics.

year to March 2014 compared to 1.7% in the rest of New Zealand. However, in recent quarters, house building costs in Auckland have shown faster quarterly growth, indicating some catch-up in price pressures. The increase in permanent and long-term arrivals from overseas has likely helped to meet some of the labour demand pressures in the industry to date, along with the fall in departures of New Zealanders, especially to Australia. Both the increase in arrivals and fall in departures have likely contributed to increased housing demand.

The mobility of resources will also influence the overall profile of the rebuild, particularly the movement of skilled staff. One such factor is the shortage of accommodation in Canterbury as the rise in the cost of living, largely owing to higher rents, may outweigh pay increases. However, anecdotal evidence suggests that construction workers are currently able to obtain housing. This suggests that housing supply is not a binding constraint on labour supply, at least in the short run. Nonetheless, the demand for housing has contributed to strong annual growth in CPI rental prices in Canterbury (4.9%) relative to the rest of New Zealand (1.5%).

Activity to date has been positive

On the whole, the value of total building work to date appears broadly supportive of the Treasury's forecast profile of the rebuild. It is evident from the data available that solid progress has been made on the residential and infrastructure fronts, while a large volume of work remains in the pipeline. However, the pace of residential completions by PMOs will need to accelerate further if the pipeline of work is to be completed in the next 4-5 years. Meanwhile, uncertainty surrounding commercial investment remains high owing to a lack of data, while progress on the central city rebuild is still in its early stages.

In coming years, the profile of work will be strongly influenced by the evolution of resource pressures and the management of insurance proceeds. At the same time, when and if all the insurance money will ultimately be reinvested in Canterbury remains uncertain. Furthermore it will be increasingly difficult to disentangle earthquake-related and underlying investment. All told, Canterbury-related investment will continue to be a significant factor in the Treasury's growth outlook.