FIRST QUARTER 2020

FORECAST REPORT 94

NEW ZEALAND TRENDS IN PROPERTY AND CONSTRUCTION

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Cover: AUT MH (Mana Hauora) Building, Auckland

CONFIDENCE TODAY INSPIRES TOMORROW

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With a network that covers the globe and a heritage spanning over two centuries, Rider Levett Bucknall is a leading independent organisation in cost management and quantity surveying and advisory services.

Our achievements are renowned: from the early days of pioneering quantity surveying, to landmark projects such as the Sydney Opera House, HSBC Headquarters Building in Hong Kong, the 2012 London Olympic Games and CityCenter in Las Vegas.

We continue this successful legacy with our dedication to the value, quality and sustainability of the built environment. Our innovative thinking, global reach, and flawless execution push the boundaries. Taking ambitious projects from an idea to reality.

FORECAST 94

Prepared by the New Zealand Institute of Economic Research (Inc.) exclusively for Rider Levett Bucknall, Forecast is produced quarterly and provides detailed local construction market intelligence and knowledge.

CONSTRUCTION MARKET INTELLIGENCE

Forecast is supplemented by Rider Levett Bucknall's construction market intelligence publications: the International Report, regional (including the Oceania Report) and country specific reports.

KEY POINTS IN THIS ISSUE

Construction activity picks up

Overall construction activity lifted in the September quarter, reflected stronger non-residential and infrastructure construction. Although residential construction declined slightly over the quarter, indicators such as consent issuance and architects' activity in their own office points to an improved pipeline over the coming year. The Government in late January announced the $12 billion New Zealand Upgrade Programme, which involves proposals to build and upgrade roads, rail, schools and hospitals over the coming years.

Non-residential construction demand led by Wellington and Auckland

Growth in non-residential construction over the past year was strongest in Wellington and Auckland. In Wellington, this largely reflected increased demand for health facilities and social buildings. Meanwhile, growth in Auckland was driven by stronger demand for office and education buildings.

Signs of easing in capacity pressures in Auckland

Although construction demand in Auckland remains strong, there are signs of an easing in capacity pressures in the Auckland construction sector. Construction cost inflation in the region is moderating as Auckland's share of total construction in New Zealand starts to ease.

Reserve Bank keeps OCR steady

Following the Reserve Bank's surprise 50 basis point cut to the Official Cash Rate (OCR) in its August meeting, interest rates were kept on hold for the remainder of 2019. The central bank also indicated less appetite to cut interest rates further in light of the improved global growth outlook. We expect the Reserve Bank to keep interest rates on hold until it embarks on a gradual tightening cycle from the end of 2021.

Basin Reserve Players Pavilion, Wellington

BUILDING ACTIVITY TRENDS

Construction activity picked up in the September quarter, as an increase in infrastructure and non-residential construction offset a small decline in residential construction. Although residential construction dipped over the quarter, indicators point to strong demand over the coming year.

Dwelling consent issuance rebounded following some softness earlier in 2019, led by strong demand in Auckland. There was also strong growth across the other main centres including Canterbury, Wellington and Waikato.

This growth reflects the effects of continued robust net migration inflows into New Zealand. The change in how Statistics NZ measures permanent and long-term arrivals and departures has resulted in frequent historical revisions to provisional estimates as more data becomes available over time. Beyond this uncertainty over the trend for net migration, the overall picture is one of solid net inflows into the economy, albeit not as strong as initially thought. Continued robust population growth should support residential construction demand over the coming years.

There has been an increase in residential consent issuance across all building types. Demand for townhouses and flats have been particularly strong over the past year, reflecting the shift towards multi-unit dwellings. Given the substantial number of dwellings required to keep up with the housing demands of a growing population, we expect a continued shift towards medium and high-density housing.

Despite the growing demand for centrally located dwellings in the main centres and shift towards higher density housing, standalone houses remain the most popular form of dwelling when it comes to new residential construction across New Zealand.

Although construction activity remains strong in Auckland, its share of total construction nationwide is starting to ease as construction demand in the other regions picks up. This includes increased construction demand in the other North Island regions, and South Island regions excluding Canterbury.

Population growth has been particularly strong in Auckland, and these effects should continue to drive overall construction demand. However, the strong population growth has begun to spill over from Auckland to the other regions. We expect this internal migration will contribute to growth in construction becoming more broad-based across New Zealand.

With Auckland's share of total construction in New Zealand easing, construction cost inflation in the region is also starting to moderate. Statistics NZ only publishes regional construction cost data for residential construction costs. Despite only covering the cost of residential construction, we still consider it a good indicator of capacity pressures in the construction sector across the regions.

Annual construction cost inflation in Auckland moderated to 2.6 percent for the year to December 2019 – well below the highs of 8.5 percent reached in late 2015. Auckland construction cost inflation is above the nationwide average of 2.4 percent but has eased below that of Wellington and South Island regions excluding Canterbury.

We expect that as construction activity continues to broaden beyond Auckland, capacity pressures in the construction sector in many other regions will increase. This should support a lift in construction cost inflation in these regions above that of Auckland's.

BUILDING ACTIVITY OUTLOOK

Although the outlook for the building sector is improving, there are headwinds facing the construction sector. The NZIER Quarterly Survey of Business Opinion (QSBO) shows a further weakening in building sector profitability, as firms struggle to raise prices against the backdrop of intense cost pressures. Firms also report caution about investing in buildings, potentially reflecting the effects of increased capital requirement for banks. These requirements have reduced banks' appetite to lend to the corporate and agriculture sector.

However, the NZIER QSBO architects' measure of activity in their own office points to a solid pipeline of construction for the year ahead. In particular, there was a strong rebound in the pipeline of government construction work, likely reflecting the government's plans for increased spending on infrastructure. The government in late January announced the $12billion New Zealand Upgrade Programme, which involves proposals to build and upgrade roads, rail, schools and hospitals over the coming years.

The pipeline for housing construction is also recovering, as higher house prices encourage new housing supply.

ECONOMIC BACKDROP

The NZ economy is showing signs of turning around, with an improvement in business confidence towards the end of 2019. The NZIER QSBO showed fewer businesses expecting a deterioration in general economic conditions over the coming months. However, firms' own activity remained soft, with a net 11 percent of businesses reporting reduced demand in the December quarter. This is the better indicator of growth in the NZ economy, and suggests annual GDP growth could ease to as low as 1 percent around the end of 2019 to early 2020.

There are downside risks to the global growth outlook stemming from the recent coronavirus outbreak, along with continued geopolitical tensions between the US and the rest of the world and uncertainty over Brexit. However, the domestic economy appears to have improved, as lower mortgage rates and population growth support stronger housing market activity and consumer confidence more generally.

INTEREST AND EXCHANGE RATES

Following the Reserve Bank's surprise decision to cut the OCR by 50 basis points at its August meeting, the central bank has kept interest rates on hold at 1 percent. It has also dampened expectations of any further monetary policy easing in light of the recent pick-up in housing market activity and signs of an improvement in domestic demand. We expect the Reserve Bank to keep its policy rate on hold until the end of 2021, before embarking on a gradual tightening cycle.

Other major central banks have eased monetary policy in recent months. The US Federal Reserve cut its Fed Funds rate further over October and November given the increased downside risks to the US growth outlook. However, its first policy rate announcement for 2020 suggests any further interest rate cuts are unlikely for the coming year.

Meanwhile, the Reserve Bank of Australia cut its policy rate by another 25 basis points in its October meeting and left the door open to further monetary policy easing. Markets expect further interest rate cuts from the Australian central bank over the coming year given the persistently low inflation outlook.

BUILDING INVESTMENT

Consent issuance suggests further growth in construction activity over 2020, albeit at a slowing rate. Population growth will remain a key support, particularly for residential construction. But caution amongst businesses towards investment should temper growth in non-residential investment.

BUILDING CONSENTS

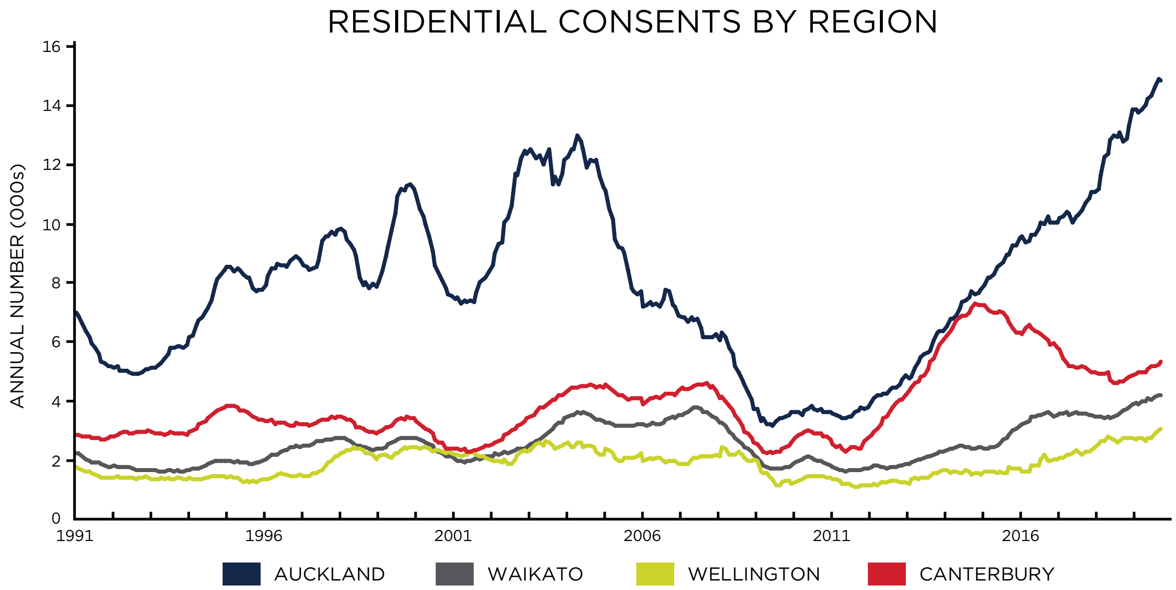
Stronger demand for accommodation was the main driver behind the increase in non-residential consent issuance, reflecting the effects of strong population growth and tourist inflows over the past year. However, increased caution about business investment has seen some easing in consent issuance since the middle of 2019, particularly when it comes to the floor area of construction consented. Nonetheless, demand remains close to the levels seen in the previous building boom in 2008.

When it comes to construction cost pressures, there has also been some easing in the measure of value of consent issuance per square metre. This easing is in line with the moderation in construction cost inflation, as well as the recent weakening in the pricing environment reported by construction sector firms in the NZIER QSBO.

FIGURE 1

Residential construction demand led by Auckland

Annual number (000s)

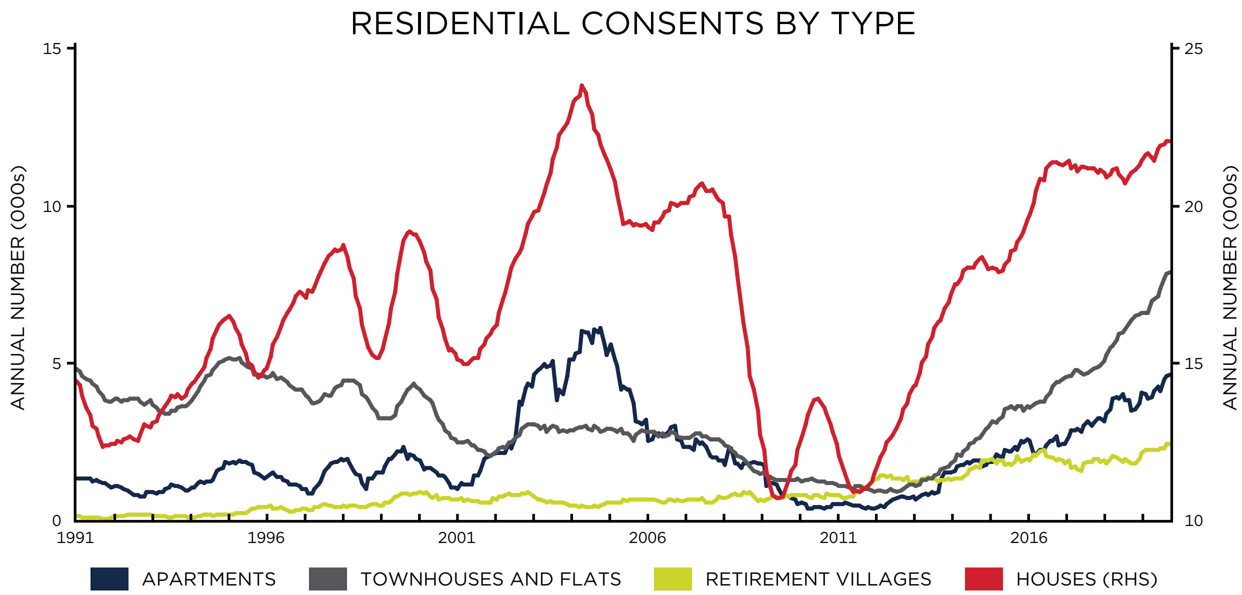


Source: Statistics NZ

FIGURE 2

Strong demand across all types of housing

Annual number (000s)



Source: Statistics NZ

Ilico Apartments, Auckland

Building consents by sector

Hostels and hotels, as well as health facilities were the top three drivers of growth in non-residential construction consent issuance over the past year. The rebound in demand for health facilities reflected stronger demand in Auckland and Wellington.

Demand for office buildings is also recovering, reflecting consent issuance for both new and alterations to office space. We expect earthquake strengthening activity will support further office consent issuance over the coming year.

In contrast, there was a decline in consent issuance for farm buildings and retail outlets over the past year. Increased capital requirements have made banks more cautious about lending to the agriculture sector, and this will likely weigh on farm investment over the coming years. Freshwater and Zero Carbon regulatory requirements also continue to present headwinds for farmers.

The government in February announced temporary restrictions on the entry into New Zealand on all foreign nationals travelling from or transiting through mainland China in response to the coronavirus. The longer the outbreak persists, the greater the impact on our tourism and international education sector, which may have implications for non-residential construction demand in these areas.

Building consents by region

Although non-residential construction demand in Auckland has eased since mid-2019, it remains one of the key regions driving the growth in New Zealand non-residential construction over the past year. Demand in neighbouring region Waikato was also strong.

Wellington led the way in non-residential construction growth over the past year, reflecting stronger demand for health and social buildings, as well as accommodation.

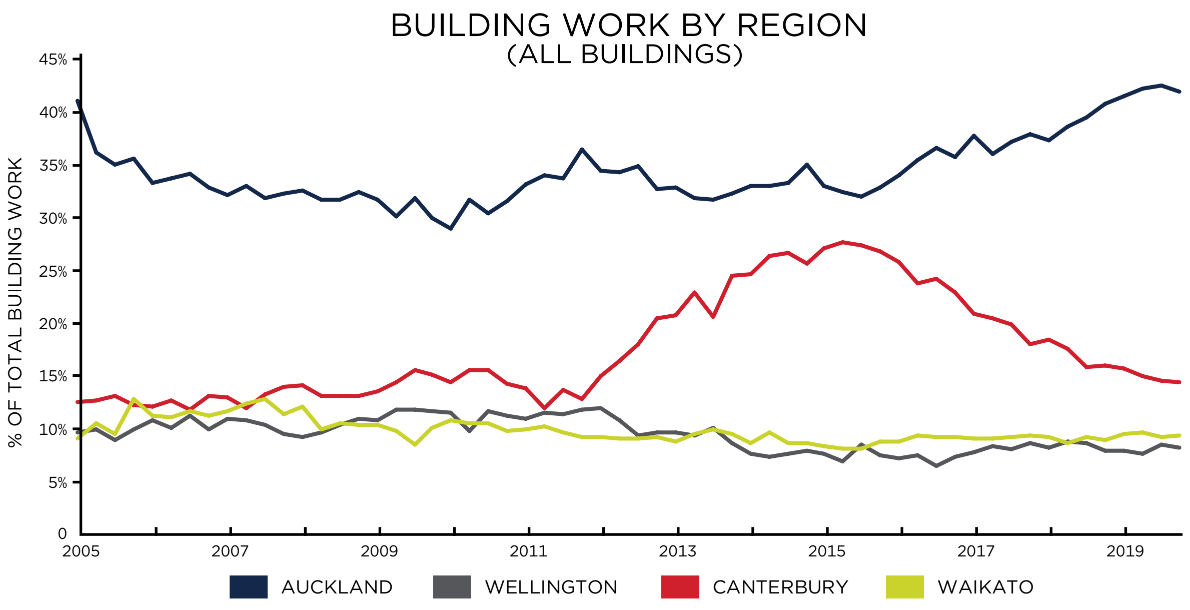
In contrast, consent issuance in Canterbury fell sharply, driven by a decline in education buildings, office space and retail outlets.

We expect robust population growth will continue to drive non-residential construction demand in the main centres over the coming year.

FIGURE 3

Construction demand becoming more broad-based across the regions

% of total building work

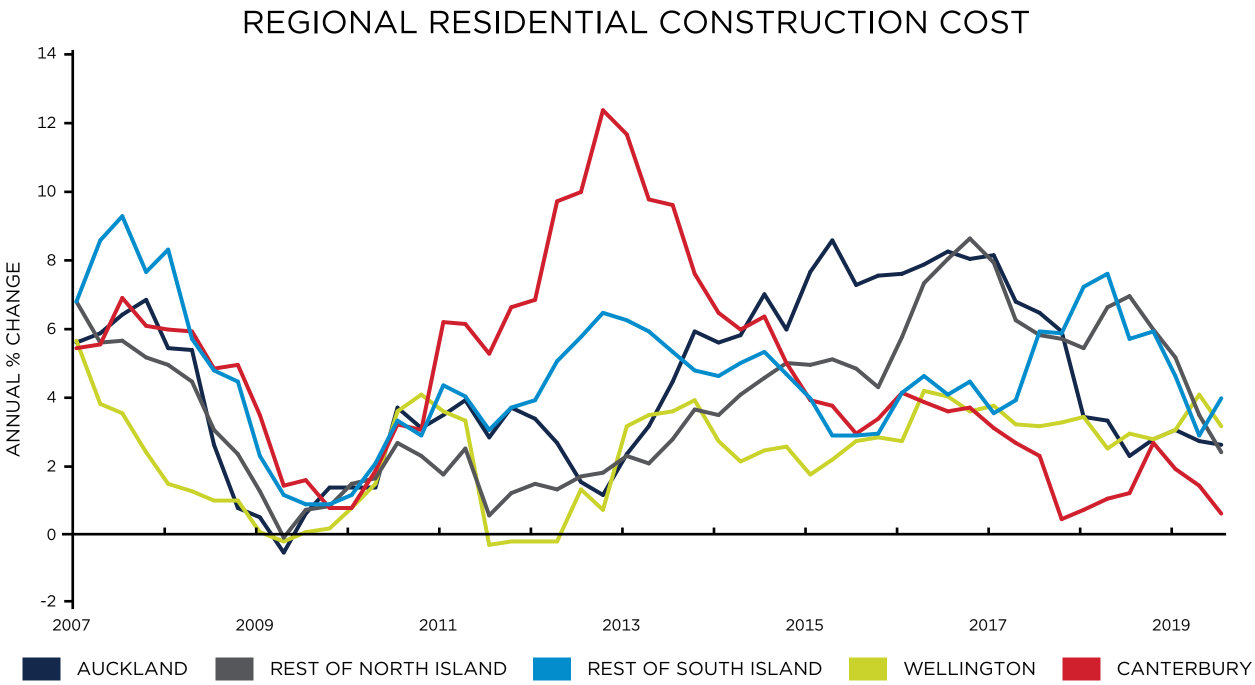


Source: Statistics NZ

FIGURE 4

Construction cost inflation in Auckland moderating

Annual % change

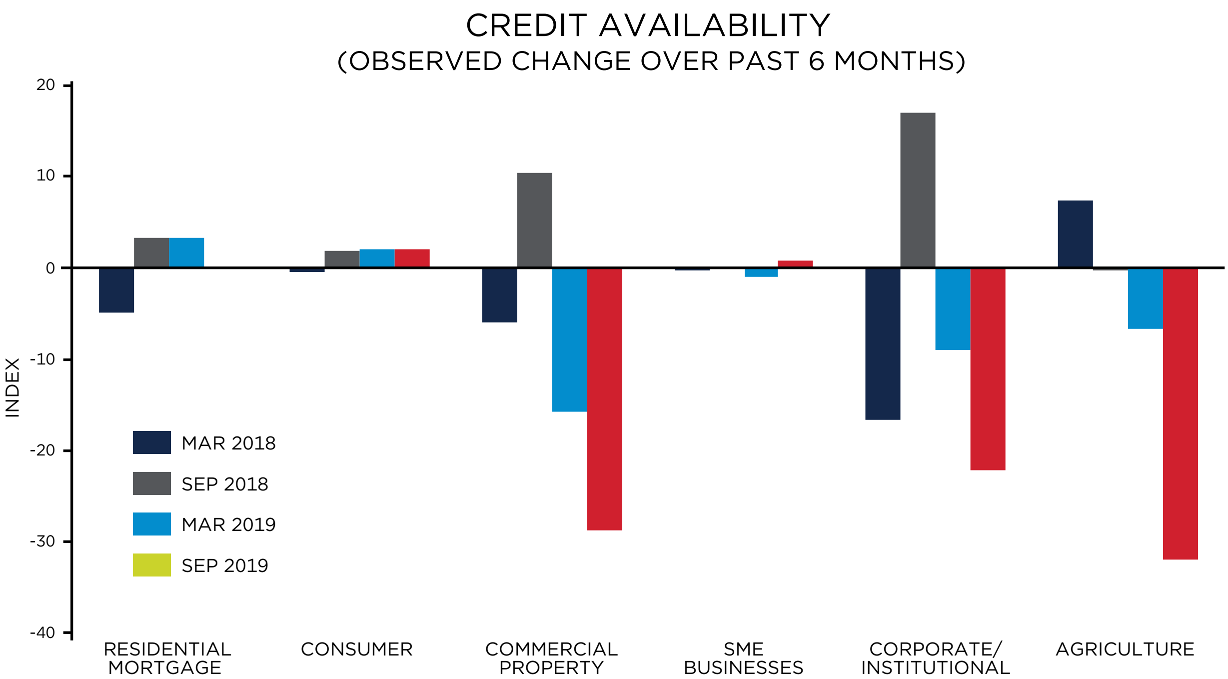


Source: Statistics NZ

FIGURE 5

Reduced appetite to lend to corporate and agriculture sector

Banks' observed change over the past 6 months

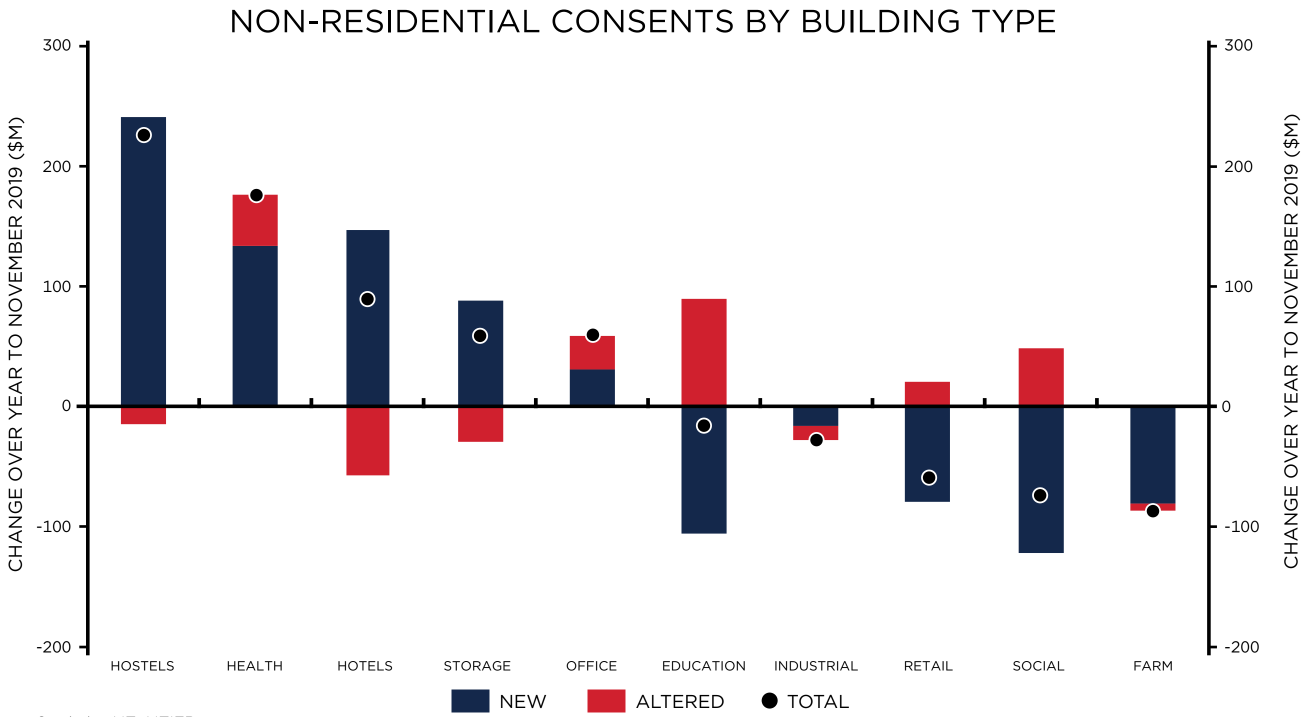


Source: RBNZ

FIGURE 6

Demand for accommodation and health facilities drive non-residential construction demand

Change over year to November 2019



Source: Statistics NZ, NZIER

TABLE 1

Non-residential building consents by region and sector

$m of consents for the year ending November 2019; red colour shading for decline in consents from previous year

	SECTOR									
REGION	HOSTELS, PRISONS ETC	ACCOMODATION	HEALTH	EDUCATION	SOCIAL, CULTURAL, RELIGIOUS	RETAIL	OFFICE	STORAGE	INDUSTRIAL	FARM
NORTHLAND	0.0	1.4	8.8	26.6	20.6	17.8	18.6	13.9	28.0	21.7
AUCKLAND	78.0	285.5	216.0	474.2	187.5	514.6	465.5	447.1	218.7	27.0
WAIKATO	125.9	15.1	35.6	64.7	26.6	73.8	87.5	70.4	138.7	77.9
BAY OF PLENTY	1.8	12.9	53.8	28.8	30.1	72.5	37.4	65.5	59.9	14.4
GISBORNE	0.1	0.1	0.1	10.0	0.9	6.1	1.9	5.6	0.6	3.7
HAWKE'S BAY	13.2	3.9	37.1	27.0	13.3	14.6	14.6	12.1	21.3	8.5
TARANAKI	0.0	4.3	1.1	18.5	6.9	8.6	10.9	6.5	9.1	12.2
MANAWATU-WANGANUI	3.6	6.5	17.6	33.1	16.0	20.1	27.7	13.5	19.1	21.0
WELLINGTON	53.0	8.1	98.1	64.7	158.1	53.9	193.2	23.4	67.6	8.9
NELSON	0.0	0.0	27.8	4.1	0.2	8.4	4.7	3.7	5.2	0.1
TASMAN	1.2	6.2	3.8	6.4	0.6	8.9	2.2	5.5	4.8	1.1
MARLBOROUGH	11.6	2.8	0.0	4.5	1.6	9.1	3.2	2.3	20.2	5.1
WEST COAST	0.0	0.8	0.4	3.1	1.2	3.8	6.0	0.3	7.3	4.0
CANTERBURY	141.4	93.1	94.1	198.4	311.7	123.6	68.1	211.7	101.5	48.2
OTAGO	3.5	76.0	31.7	64.4	9.8	55.0	35.4	27.6	49.1	23.6
SOUTHLAND	0.1	1.9	3.3	5.2	2.3	40.1	3.8	7.6	20.5	9.7

Source: Statistics NZ, NZIER

Te Toki a Rata Building, Wellington

BUILDING COSTS

The Capital Goods Price Index for Non-Residential Buildings (CGPI-NRB) (the Index) is an official measure of cost movements in the sector. The Index excludes GST. We use the Index as an indicator of cost escalation.

The Index is a national average across all building types. We therefore advise caution in applying the increase in the CGPI-NRB as an indicator of cost escalation for specific projects.

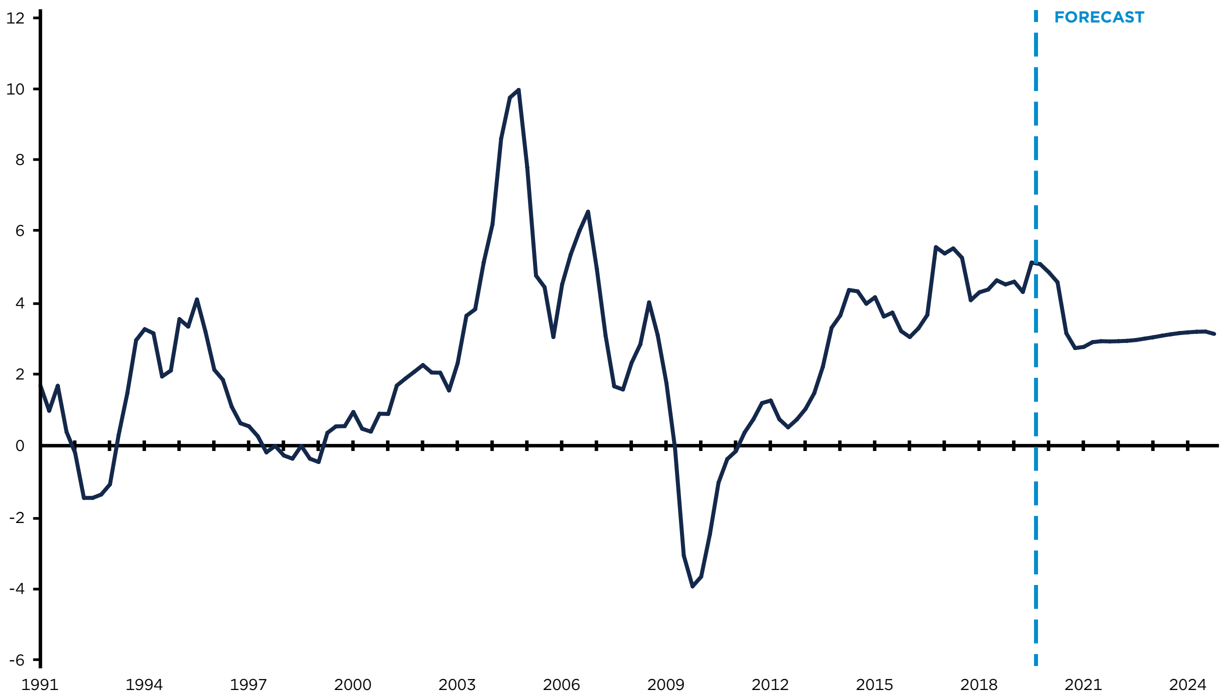
The Rider Levett Bucknall (RLB) Fourth Quarter 2019 Oceania Report provides local regional comment and tender price relativity between the main New Zealand and Australian centres. This publication is available at www.rlb.com or on request from any RLB office.

Non-residential construction cost increased sharply in the September 2019 quarter. We expect a moderation in construction cost inflation from these high levels over the coming year given signs of easing capacity pressures in the construction sector. We expect annual inflation will edge down to around 4 percent at the end of 2020, before moderating further to around 3 percent in the subsequent years.

FIGURE 7

Non-residential building cost escalation

CGPI-NRB index, annual % change



Source: Statistics NZ, NZIER forecasts

TABLE 2

Non-residential building cost index

YEAR	QUARTER	INDEX	QUARTERLY % CHANGE	ANNUAL % CHANGE
2015	MARCH	1474	1.0	4.2
	JUNE	1484	0.7	3.6
	SEPTEMBER	1498	0.9	3.7
	DECEMBER	1507	0.6	3.2
2016	MARCH	1519	0.8	3.1
	JUNE	1533	0.9	3.3
	SEPTEMBER	1553	1.3	3.7
	DECEMBER	1591	2.4	5.6
2017	MARCH	1601	0.6	5.4
	JUNE	1618	1.1	5.5
	SEPTEMBER	1635	1.1	5.3
	DECEMBER	1656	1.3	4.1
2018	MARCH	1670	0.8	4.3
	JUNE	1689	1.1	4.4
	SEPTEMBER	1711	1.3	4.6
	DECEMBER	1731	1.2	4.5
2019	MARCH	1747	0.9	4.6
	JUNE	1762	0.9	4.3
	SEPTEMBER	1799	2.1	5.1
	DECEMBER	1819	1.1	5.1
2020	MARCH	1832	0.7	4.9
	JUNE	1843	0.6	4.6
	SEPTEMBER	1856	0.7	3.2
	DECEMBER	1869	0.7	2.7
2021	MARCH	1883	0.7	2.8
	JUNE	1897	0.7	2.9
	SEPTEMBER	1910	0.7	2.9
	DECEMBER	1924	0.7	2.9
2022	MARCH	1938	0.7	2.9
	JUNE	1952	0.7	2.9
	SEPTEMBER	1967	0.7	3.0
	DECEMBER	1982	0.8	3.0
2023	MARCH	1997	0.8	3.0
	JUNE	2013	0.8	3.1
	SEPTEMBER	2029	0.8	3.1
	DECEMBER	2045	0.8	3.2
2024	MARCH	2061	0.8	3.2
	JUNE	2077	0.8	3.2
	SEPTEMBER	2094	0.8	3.2
	DECEMBER	2109	0.7	3.1

Notes: The current and forecast CGPI-NRB is a national average, which does not differentiate between regions or building types. We therefore advise caution in applying the increase in the CGPI-NRB as a measure of cost escalation for specific building projects.

Source: Statistics NZ, NZIER forecasts

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