FOURTH QUARTER 2018

FORECAST REPORT 89

NEW ZEALAND TRENDS IN PROPERTY AND CONSTRUCTION

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Cover: University of Auckland, Science Centre, Auckland

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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 89

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

Construction activity picked up over the second quarter of 2018, partly reversing the declines across the residential, commercial and Government sectors in the previous quarter. Underlying demand remains very strong, with the surge in population in previous years continuing to support strong residential construction demand, particularly in Auckland.

Net migration continues to slow

Net migration continued to slow, reflecting a decline in the number of people moving into the country and an increase in the number of departing New Zealand. However, the number of trades workers moving here continues to increase, reflecting strong labour demand in the construction sector.

Non-residential construction demand driven by Auckland growth

Auckland continues to lead the strength in non-residential construction demand, driven by increased demand for education, retail and industrial buildings. Demand for new retail buildings also grew strongly in the Bay of Plenty.

Interest rates on hold until at least early 2020

The Reserve Bank of New Zealand in its August Monetary Policy Statement highlighted the risk of a cut in the Official Cash Rate. However, the subsequent release of June quarter GDP data showing solid growth in the New Zealand economy has reduced market expectations of a cut in interest rates. Given the balance of risks, we now expect the OCR to be on hold until at least early 2020.


Te Toki a Rata building, Victoria University of Wellington, Wellington

BUILDING ACTIVITY TRENDS

Construction picked up in the second quarter of 2018, reflecting increased activity across the residential, commercial and Government sectors. The increases partly reversed the declines in the previous quarter, as capacity and financing constraints had hampered construction activity. Underlying construction demand remains very strong, reflecting the effects of the population surge in recent years.

However, net migration has slowed over the past year. The number of people moving into the country continues to ease, while the number of people leaving New Zealand continues to pick up. Part of this lift in permanent departures reflects people on temporary work and student visas returning to their home countries as the tenure of their visas ends.

Net outflows to Australia continue to increase, largely reflecting increased number of New Zealand citizens heading across the Tasman. We expect an improving Australian labour market will drive further net outflows over the coming year, although it is unlikely to reach the historical average net annual outflow of around 16,000 per year.

The decline in the number of people moving to New Zealand on student and permanent residency visas since 2016 is in contrast to the continued growth in the number of work visas. This growth in work visa approvals is driven by an increased number of technicians and trades workers moving into the country in response to the strong demand in the construction sector.

We expect this shift in the composition of people moving to New Zealand to continue, as the Government focuses on bringing workers in where labour demand is greatest. Despite indicating it will look to tighten migration settings, strong construction demand and acute labour shortages in the sector means the number of construction-related workers moving into the country is likely to lift further. The extent to which capacity constraints including labour shortages can be alleviated will influence the extent to which construction activity can ramp up over the coming years.

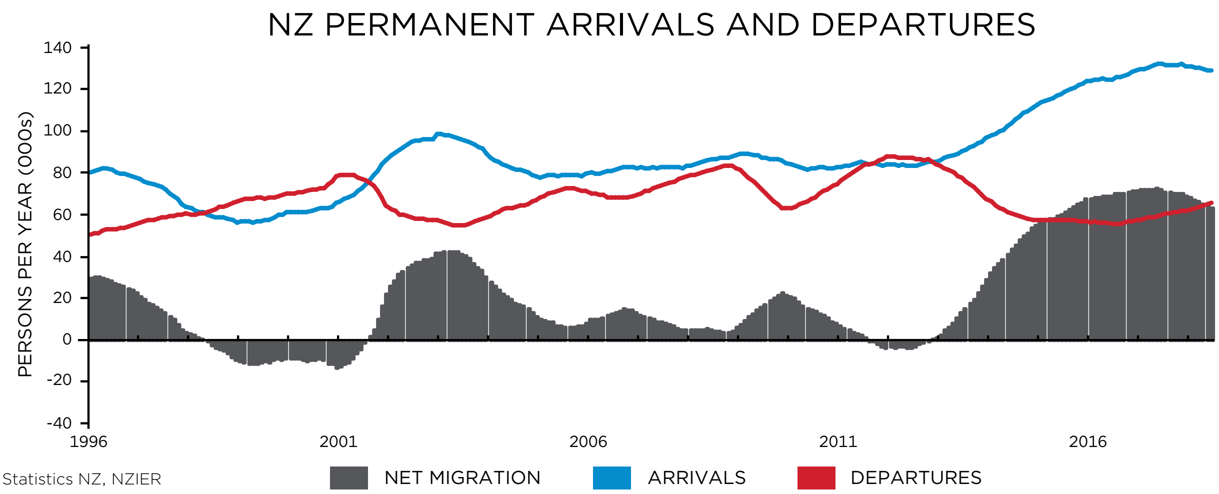
Despite the more recent slowing in population growth, the surge in population since 2013 has boosted demand for construction, particularly housing. The NZIER Quarterly Survey of Business Opinion (QSBO) showed architects expected some slowing in the pipeline of non-residential and Government work in the June quarter. Part of this is likely to reflect uncertainty over the Government's changing priorities in regard to infrastructure construction. Meanwhile, deteriorating business confidence may curtail some investment in new buildings.

Despite this uncertainty, underlying construction demand remains strong. In particular, there is strong demand for residential housing. The main issue is whether there is enough capacity to enable the Government's Kiwibuild plan for 100,000 dwellings to be built over the next decade. Capacity constraints are particularly pertinent in Auckland, where around half of the Kiwibuild dwellings are planned to be built given the concentration of population growth in the region.

FIGURE 1

Net migration continues to slow

Persons per year (000s)



Source: Statistics NZ, NZIER

BUILDING ACTIVITY OUTLOOK

BUILDING ACTIVITY OUTLOOK

The recent slowing in the pipeline of construction work, in some regions, is likely to reflect changes to the timing of activity rather than slowing demand. Underlying construction demand remains strong, but there is uncertainty as to when some developments will commence. This uncertainty reflects financing constraints and changes in Government priorities. We expect that as the Government implements its plans for infrastructure, including education buildings and healthcare facilities, there will be a rebound in non-residential and Government construction.

The Government's Kiwibuild plan to build 100,000 dwellings over the coming decade has got off to a slow start, with growth hampered by capacity constraints. The Government expects 1,000 dwellings will be built this year, and for this to ramp up to around 12,000 dwellings per year from 2020. To the extent part of the Kiwibuild plan involves the Government buying off the plan of developments already underway, Kiwibuild is likely to bring forward projects which otherwise may have taken longer to source financing.

Growth in residential housing continues to shift towards multi-unit dwellings such as apartments and townhouses, while demand for standalone houses eases. We expect further intensification of housing, given the focus on making the most effective use of available land. However, the construction sector continues to face many challenges to this intensification, including low operating margins, labour shortages and uncertainty of cashflow, particularly amongst smaller and mid-sized firms.

Given the reluctance of major construction companies such as Fletcher Building to engage in further "vertical construction" work, there remains a large degree of uncertainty over which construction companies will have a sufficiently large balance sheet to lead the construction of larger developments in private and public sectors.

ECONOMIC BACKDROP

Businesses have become increasingly downbeat over the past year. Uncertainty over Government policy changes and the implications for business costs as well as demand has clouded business confidence. Businesses' own trading activity has also eased, but to a lesser degree. Businesses have become more circumspect about planning for the future in the face of deteriorating profitability, as largely reflected in an easing in investment intentions.

Uncertainty also stems from downside risks to the global growth outlook. Increasing trade tensions between the US and many of the major economies including China is causing jitters in the financial markets. The US Federal Reserve is also continuing to lift interest rates, which has particularly large implications for emerging market economies which rely on low offshore borrowing costs.

Solid June quarter GDP growth figures indicate the New Zealand economy remains robust, but we expect a moderation in growth over the coming year. We continue to expect annual GDP growth to average around 3 percent over the next five years.

INTEREST AND EXCHANGE RATES

Non-construction inflation remains contained, but there are signs of a renewed modest pick-up in non-tradeable inflation. This lift largely reflects strong growth in housing-related prices such as construction, rents, electricity and fuel charges. Most core measures of inflation generally remain stable, as have inflation expectations. We expect underlying inflation to firm over the medium term as capacity pressures in the economy broaden beyond housing.

The comparatively fast pace of monetary tightening in the United States – first by ending quantitative easing and then through raising the Fed Funds rate – has led to a nearly 20 percent appreciation of the US dollar on a trade-weighted basis over the past four years.

Despite the Reserve Bank here in New Zealand highlighting the potential for an interest rate cut if growth was to pick up at a more subdued pace than they forecast, recent strong June quarter GDP data have reduced the likelihood have lower interest rates. Nonetheless, we expect the OCR will be on hold until at least early 2020.

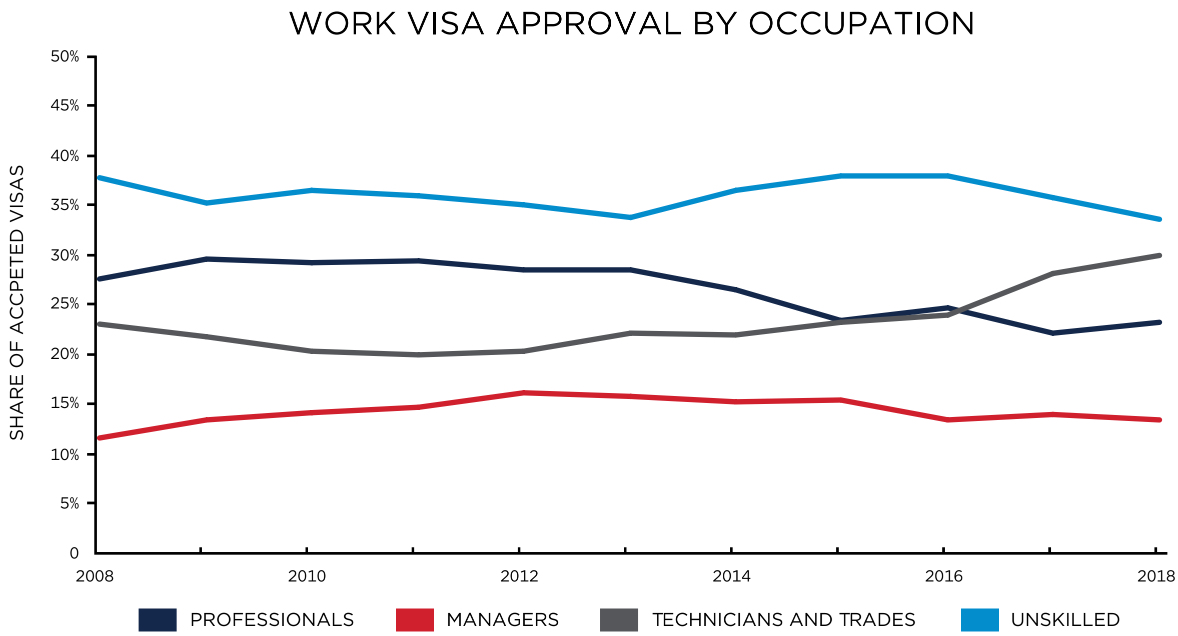
BUILDING INVESTMENT

The NZIER Quarterly Survey of Business Opinion's architects' measure of own activity points to a slowing pipeline of commercial and public sector work. However, we expect this largely reflects a timing issue, with growth likely to resume once there is greater certainty over Government policies and the infrastructure developments it will implement.

FIGURE 2

More trades workers moving to NZ given construction boom

% of accepted work visas



Source: Immigration NZ, NZIER

Justice & Emergency Services Precinct, Christchurch

BUILDING CONSENTS

Demand for new retail outlets was the top driver of growth in non-residential construction demand over the past year, led by Auckland and the Bay of Plenty. Demand for industrial, farm and storage buildings also grew strongly. The recovery in global commodity prices have meant an improvement in on-farm profitability, with farmers feeling confident enough about the sustainability of this income to start looking towards investment.

In contrast, consent issuance for new accommodation and office buildings have fallen sharply over the past year, with some offset from an increase in alterations to existing buildings. We expect the absence of major firms willing to lead the construction of large-scale vertical construction will limit growth in consent issuance for these buildings in the coming year.

Building consents by sector

Capacity constraints will likely limit the extent of growth in large-scale construction developments in the near term. However, population growth (while moderating) and tourism demand should continue to underpin many of the longer-term trends:

- Office growth to accommodate the higher number of white collar workers.
- New accommodation buildings in response to the continued high numbers of international visitors, as well as strong domestic tourism activity.

Earthquake strengthening activity should also continue to contribute to non-residential construction demand.

Building consents by region

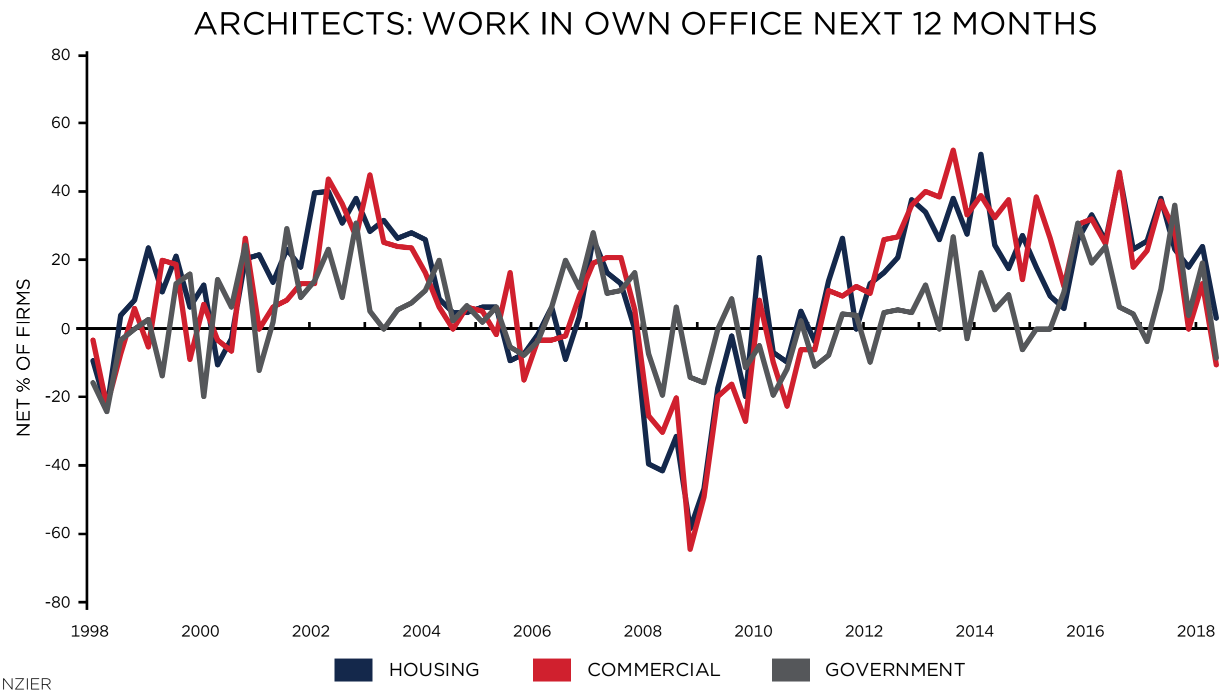
Growth in construction continues to be led by Auckland, reflecting the effects of strong population growth in the region. This growth in Auckland over the past year was broad-based across the sectors, with particularly strong demand for retail outlets and education buildings. Demand for industrial and storage buildings also grew strongly in Auckland over the past year.

The effects of strong population growth in Auckland has spilled over to its neighbouring regions, with non-residential construction demand growing strongly in Waikato and Bay of Plenty. Over the past year, this growth has been driven by increased demand for healthcare facilities and farm buildings in Waikato, and retail outlets and office buildings in the Bay of Plenty.

FIGURE 3

Architects expect some slowing in non-residential and Government work

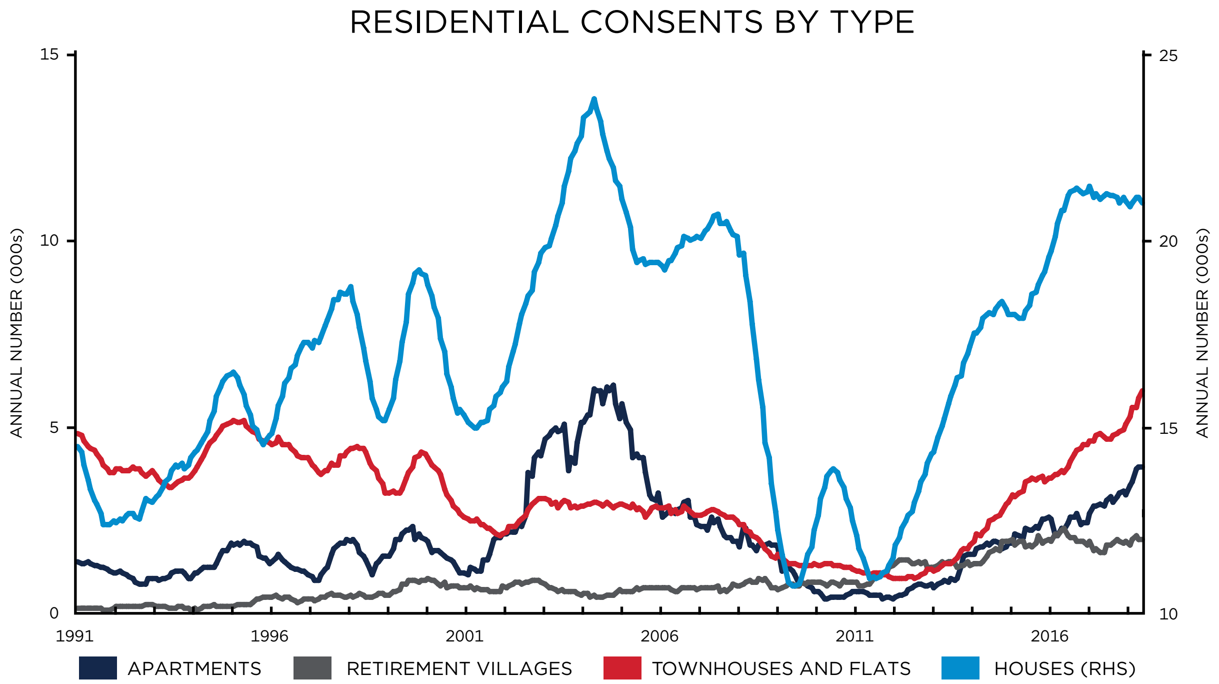
Net % of firms



Source: NZIER

FIGURE 4

Continued demand for intensification of housing

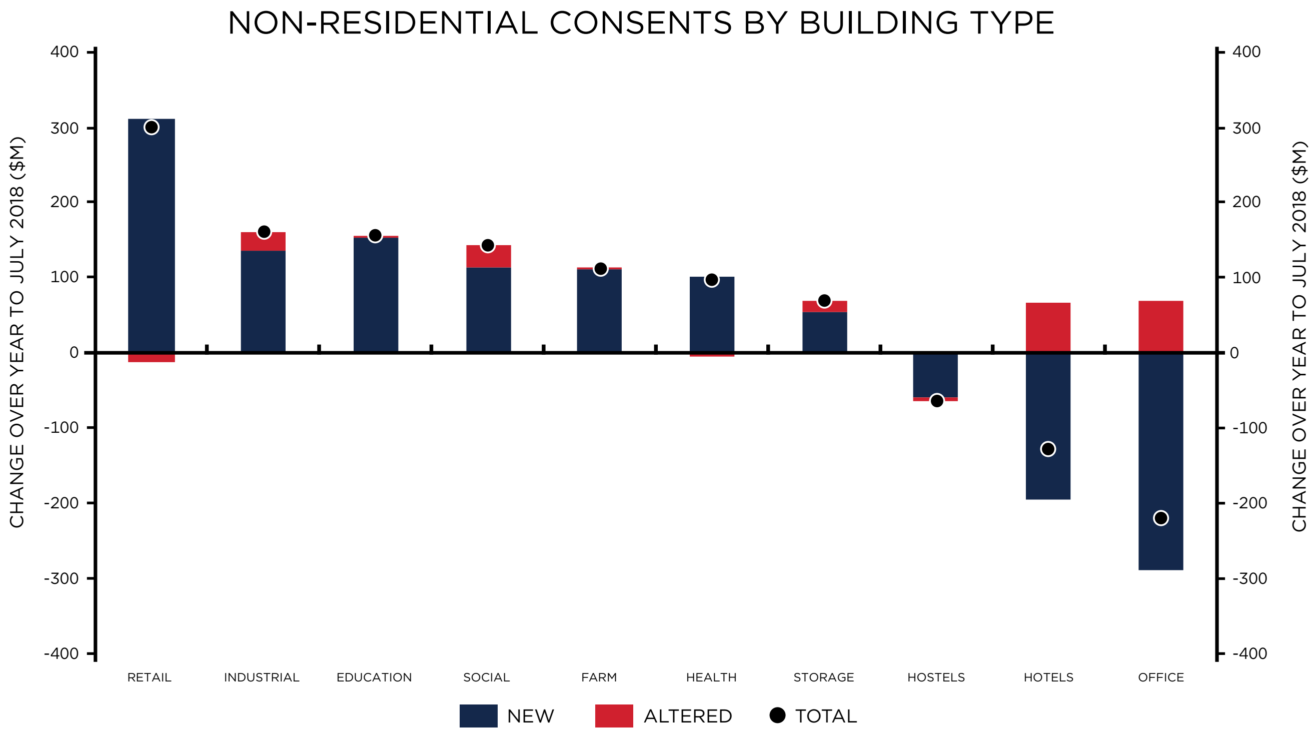


Source: Statistics NZ, NZIER

FIGURE 5

Strong retail demand in Auckland drives non-residential construction growth

Annual change in consents, $m, year ended April 2018

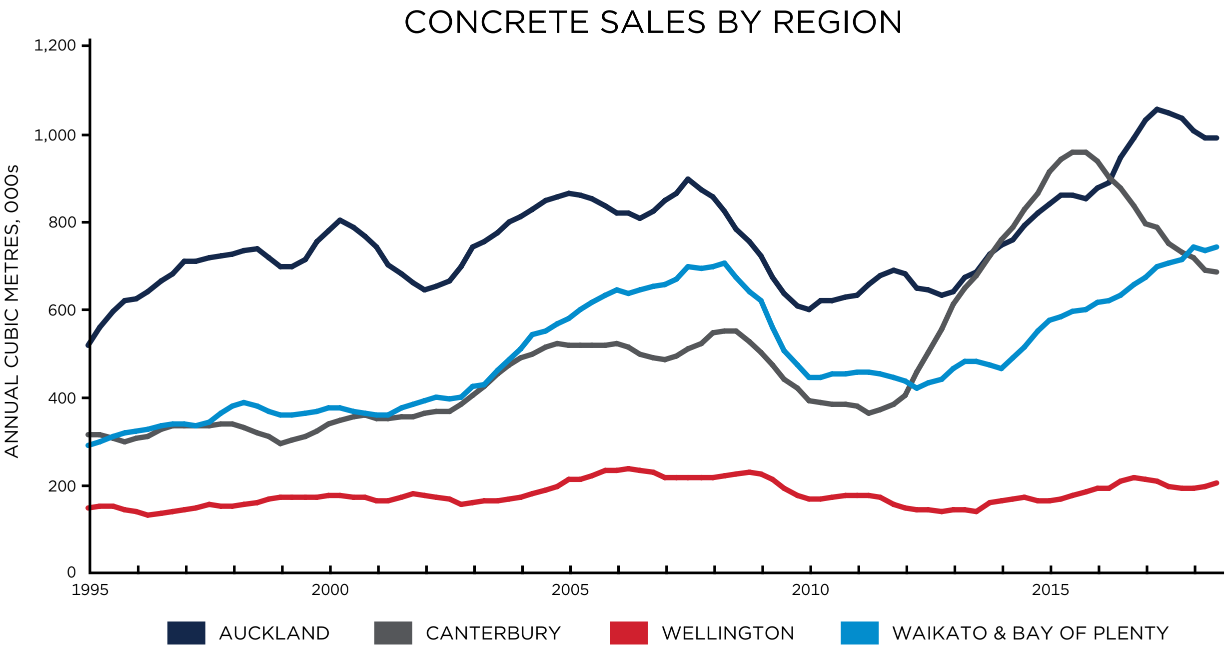


Source: Statistics NZ, NZIER

FIGURE 6

Construction demand led by Auckland and its surrounding regions

Annual cubic metres 000s)



Source: Statistics NZ

TABLE 1

Non-residential building consents by region and sector

$m of consents for the year ending July 2018; red colour shading for decline in consents from previous year

REGION	SECTOR: HOSTELS, PRISONS ETC	ACCOMODATION	HEALTH	EDUCATION	SOCIAL, CULTURAL, RELIGIOUS	RETAIL	OFFICE	STORAGE	INDUSTRIAL	FARM
NORTHLAND	2.8	16.8	19.8	30.9	20.8	8.9	24.6	5.5	6.2	14.9
AUCKLAND	117.2	173.9	150.4	556.1	246.2	470.2	422.8	369.4	273.9	25.9
WAIKATO	0.4	4.3	83.5	62.9	25.6	39.0	51.1	63.2	107.0	99.7
BAY OF PLENTY	0.6	30.1	29.6	30.7	20.9	136.6	94.7	88.9	54.7	11.2
GISBORNE	0.0	1.0	0.0	2.5	4.0	2.2	3.2	2.5	2.3	2.7
HAWKE'S BAY	1.6	2.8	18.4	15.5	17.0	7.1	27.2	25.4	17.0	5.2
TARANAKI	0.0	0.9	3.3	20.2	3.5	13.3	12.1	9.3	11.7	28.2
MANAWATU-WANGANUI	1.0	1.4	17.2	60.5	13.9	11.0	18.0	20.6	28.1	16.9
WELLINGTON	0.9	25.9	46.1	73.2	55.5	49.3	138.0	21.0	49.1	6.8
NELSON	2.9	0.0	20.3	3.0	0.8	2.4	4.8	4.2	7.7	0.4
TASMAN	0.0	0.7	3.6	3.3	0.2	1.9	3.8	17.8	6.4	4.7
MARLBOROUGH	1.4	1.0	7.2	1.4	7.1	4.9	2.9	5.4	10.2	3.7
WEST COAST	0.0	4.6	0.5	2.2	1.0	1.4	1.1	2.5	2.5	4.4
CANTERBURY	16.0	59.7	132.0	244.7	227.0	213.2	163.6	121.0	121.9	92.6
OTAGO	2.1	37.6	19.4	53.4	10.9	55.7	41.2	27.5	24.7	23.6
SOUTHLAND	0.1	3.3	0.1	3.8	4.6	8.3	8.5	4.4	28.8	12.4

Source: Statistics NZ, NZIER

King’s School Centennial Building, Auckland

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 Second Quarter 2018 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 Rider Levett Bucknall office.

We forecast construction cost inflation to lift to around 4.5 percent in mid- 2019 before moderating to 4 percent by the end of 2019. Beyond that, we expect annual construction cost inflation to ease to around 3.3 percent at the end of 2020, as capacity pressures in the construction sector eases.

We expect an extended period where construction cost inflation is elevated. The exit of Fletcher Building from the "vertical construction" sector increases the uncertainty over the degree of construction cost escalation, but large cost increases are likely to see a push-back in demand as developments no longer become financially feasible.

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
2013	MARCH	1365	0.5	1.0
	JUNE	1372	0.5	1.5
	SEPTEMBER	1383	0.8	2.1
	DECEMBER	1402	1.4	3.2
2014	MARCH	1413	0.8	3.5
	JUNE	1429	1.1	4.2
	SEPTEMBER	1440	0.8	4.1
	DECEMBER	1456	1.1	3.9
2015	MARCH	1471	1.0	4.1
	JUNE	1480	0.6	3.6
	SEPTEMBER	1494	0.9	3.8
	DECEMBER	1502	0.5	3.2
2016	MARCH	1514	0.8	2.9
	JUNE	1529	1.0	3.3
	SEPTEMBER	1548	1.2	3.6
	DECEMBER	1586	2.5	5.6
2017	MARCH	1595	0.6	5.4
	JUNE	1613	1.1	5.5
	SEPTEMBER	1629	1.0	5.2
	DECEMBER	1650	1.3	4.0
2018	MARCH	1664	0.8	4.3
	JUNE	1683	1.1	4.3
	SEPT	1703	1.2	4.6
	DEC	1724	1.2	4.5
2019	MARCH	1741	1.0	4.7
	JUNE	1758	1.0	4.5
	SEPTEMBER	1776	1.0	4.2
	DECEMBER	1793	1.0	4.0
2020	MARCH	1810	0.9	3.9
	JUNE	1826	0.9	3.9
	SEPTEMBER	1842	0.9	3.8
	DECEMBER	1858	0.9	3.6
2021	MARCH	1874	0.9	3.6
	JUNE	1890	0.9	3.5
	SEPTEMBER	1906	0.9	3.5
	DECEMBER	1923	0.9	3.5
2022	MARCH	1939	0.9	3.5
	JUNE	1956	0.9	3.5
	SEPTEMBER	1972	0.8	3.4
	DECEMBER	1986	0.7	3.3

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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