FOURTH QUARTER 2019

FORECAST REPORT 93

NEW ZEALAND TRENDS IN PROPERTY AND CONSTRUCTION

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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 93

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 eases

There was a decline in both residential and non-residential construction activity in the June quarter. However, consent issuance over the past year and a half suggests some pick up in construction demand over the second half of 2019.

Migration data points to solid net inflows

The new and revised migration data from Statistics NZ suggest net migration inflows remain solid. Given the estimation involved with the new methodology, recent months' results are prone to revisions. Beyond the near-term volatility, the picture looks to be one of continued solid net inflows into New Zealand. This should support construction demand over the coming years.

Non-residential construction demand led by Canterbury and Auckland

Non-residential construction demand was strongest in Canterbury and Auckland over the past year. Strong demand for education facilities and social buildings drove the strength in Canterbury, while the strength was broad-based in Auckland.

Reserve Bank cuts OCR by 50 basis points

The Reserve Bank cut its policy rate by 50 basis points, and left the door open for further monetary policy easing. We expect a further decline in interest rates, which should support housing demand and construction activity.

56 The Terrace, Wellington

BUILDING ACTIVITY TRENDS

Construction activity eased in the June quarter, driven by a decline in both residential and non-residential construction. The easing follows solid growth since late 2018, and consent issuance over the past eighteen months point to a pick-up in construction activity over the second half of 2019.

Solid population growth should continue to underpin construction demand. Across the regions, Auckland continues to have the dominant share of total construction activity. Demand for retail outlets and storage buildings in the region has been strengthening over the past year. Given population growth has been particularly strong in Auckland, we expect the region will continue to drive overall construction demand.

Although Canterbury's *share* of construction activity in New Zealand has fallen over the past year, consent issuance nonetheless points to stronger construction demand. This should flow through to activity over the coming year.

Meanwhile, Wellington is starting to have a greater share of total construction activity. This largely reflects stronger non-residential construction. In contrast, residential construction in Wellington has been surprisingly flat over the past year, despite the surge in Wellington house prices.

The new passport-linked measure of permanent arrivals and departures require provisional estimates to be made which makes the net migration data prone to revisions in the subsequent months. A permanent arrival or departure is defined as someone who has stayed in or out of the country 12 of the past 16 months since they crossed the border.

Beyond this uncertainty, the trend appears to be one of continued solid net inflows into New Zealand. The number of people coming into the country continues to rise, but this has been partly offset by a modest increase in the number of people leaving the country. This migration-led population growth should continue to support construction demand over the coming year.

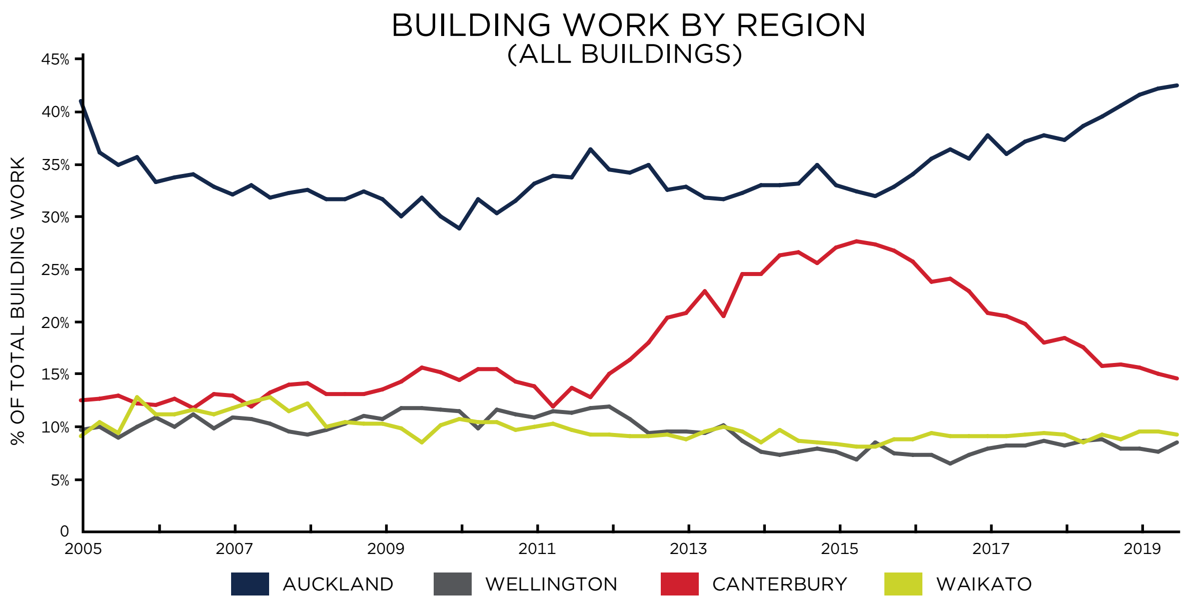
Despite the more recent easing in activity, residential construction demand remains strong as population growth continues to boost housing demand. There has been a shift in construction demand towards medium and high density housing. This trend has been particularly apparent in Auckland, as relatively more acute infrastructure constraints boosted demand for centrally-located dwellings in the region.

Although standalone houses remain the most popular form of dwelling, there has been a surge in consent issuance for multi-unit dwellings over the past year, particularly townhouses and flats.

FIGURE 1

Auckland continues to dominate construction activity

% of total building work



Source: Statistics NZ

BUILDING ACTIVITY OUTLOOK

Although underlying construction demand remains solid, the June quarter NZIER *Quarterly Survey of Business Opinion* (QSBO) shows profitability in the sector remains weak, although there are signs the trend is turning around. Cost pressures remain intense, and pricing power is only just starting to recover in the construction sector. Firms are pessimistic about any improvement in profitability in the near term, with the June QSBO showing a net 31 percent of building sector firms expect a deterioration in profitability.

Issues over which parties bear the risk of cost overruns for development continue to hamper construction developments. Procurement practices which place the burden of cost overruns on construction firms have seen some construction firms fall into financial difficulty in the face of strong construction cost escalation.

The recent Constructive Construction Industry Forum highlighted the need for procurement processes to be amended so there was an incentive for construction firms to focus on long-term sustainability through bolstering their balance sheet and training staff. Labour shortages and the Resource Management Act's restrictions on urban development were also seen as impediments to construction growth.

ECONOMIC BACKDROP

Growth in the New Zealand economy has slowed over the past year. We expect growth to remain around these lower rates over the coming year. Over the longer term, we now forecast annual GDP growth to average just over 2 percent over the next five year. Uncertainty over how the trade war between the US and China is likely to be weigh on demand for New Zealand exports.

Although uncertainty over the global growth outlook and Government policy will likely dampen demand, the effects of strong population growth should continue to support other areas of demand. In particular, we expect the easing in construction in the June quarter will be temporary and activity will recover.

INTEREST AND EXCHANGE RATES

The Reserve Bank surprised markets by cutting the OCR by 50 basis points in its August meeting, and left the door open for further monetary policy easing. Given the central bank's primary concern with the deterioration in the global growth outlook, we expect at least one further interest rate cut over the coming year.

Other major central banks have also eased monetary policy. The US Federal Reserve cutting its policy rate by another 25 basis points at its September meeting to a range of 1.75 to 2 percent – the second decrease since late July. Although the central bank noted that current economic conditions remained robust, it was mindful of downside risks to the growth outlook.

The NZD/USD has fallen sharply in the wake of the large cut to NZ interest rates, as NZD-denominated investments look less attractive from a yield perspective. We expect it will pick up towards 65 cents on average over the coming year, as other central banks also embark on further monetary policy easing.

BUILDING INVESTMENT

Consent issuance suggests construction activity will pick up over the remainder of 2019, reflecting the effects of the solid population growth in recent years which is continuing to support underlying construction demand.

BUILDING CONSENTS

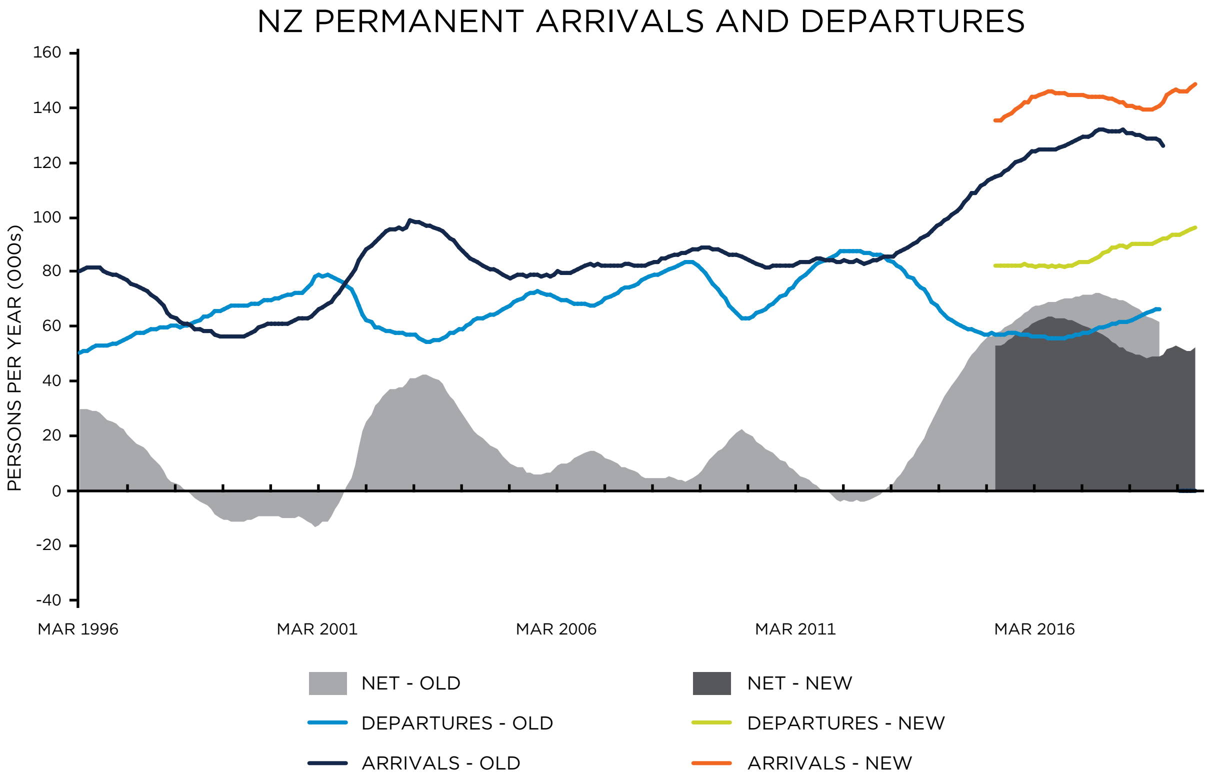
There has been a slight easing in non-residential construction consent issuance in more recent months, but demand remains high and close to the levels seen in the previous building boom in 2008. The measure of value of consent issuance per square metre, which is considered a proxy of construction cost pressures, has lifted. This suggests construction cost escalation remains high, reflecting continued capacity pressures in the construction sector.

Non-residential construction demand over the past year has been particularly strong for accommodation. Growth in both the number of people living in and visiting New Zealand show signs of easing, and this will likely start to weigh on demand for this type of non-residential construction over the coming years.

FIGURE 2

Net migration inflows remain solid

Annual number of people



Source: Statistics NZ

H&M Commercial Bay, Auckland

Building consents by sector

Social buildings, hostels and storage buildings were the top three drivers of growth in non-residential construction consent issuance over the past year. In contrast, demand for education and health facilities, as well as farm and office buildings declined over the past year.

Uncertainty over how the trade war between the US and China will play out is starting to dampen demand for New Zealand commodity exports. Increased freshwater and Zero Carbon regulatory requirements are additional headwinds for farms over the longer term. We expect these factors will discourage on-farm investment in areas such as farm buildings. Meanwhile, the decline in demand for new office developments follows strong growth in recent years. Looking ahead, earthquake strengthening activity should continue to contribute to non-residential construction demand.

Building consents by region

Non-residential construction demand in Auckland has eased in recent months, but demand still grew over the past year and it remains the dominant driver of non-residential construction activity.

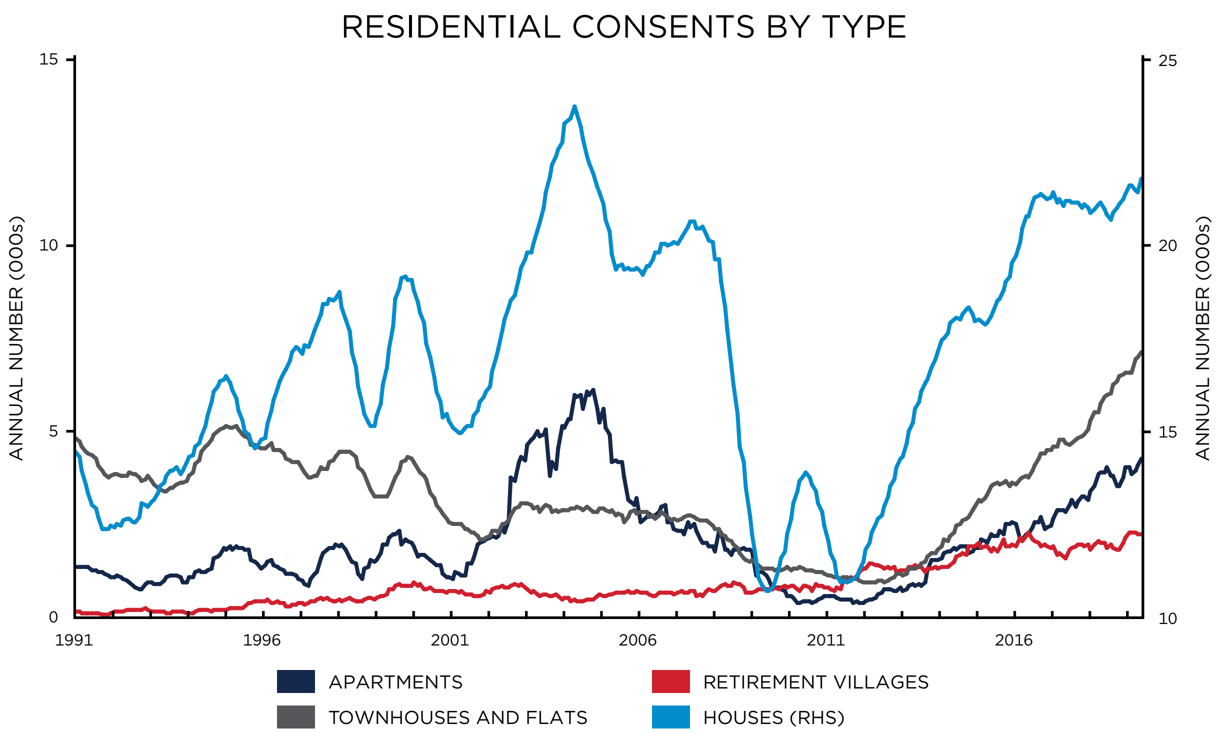
Non-residential construction demand in Canterbury picked up strongly over the past year, reflecting increased demand for social buildings, hostels and education facilities in the region. Stronger demand for hostels also drove the growth in non-residential construction demand in Waikato.

We expect the effects of strong population growth will continue to drive relatively strong non-residential construction demand in Auckland over the coming years.

FIGURE 3

Shift towards higher density housing

Annual number of consents issued

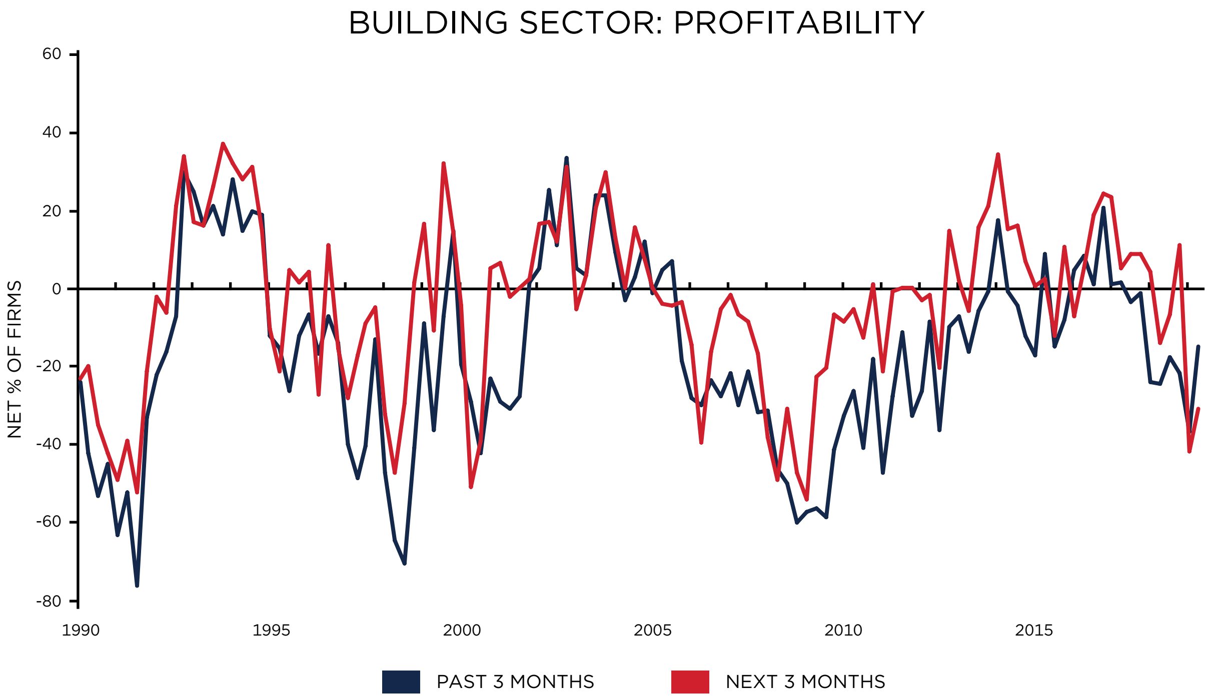


Source: Statistics NZ

FIGURE 4

Margin compression continues to weigh on construction prospects

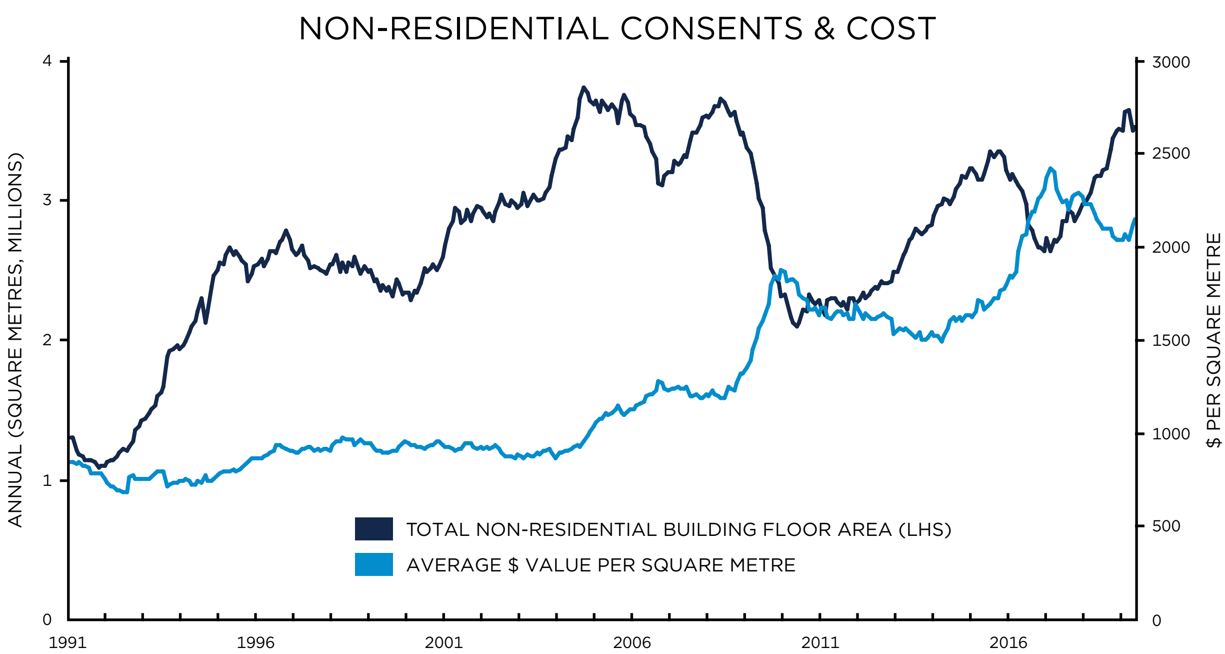
Net % of firms



Source: NZIER

FIGURE 5

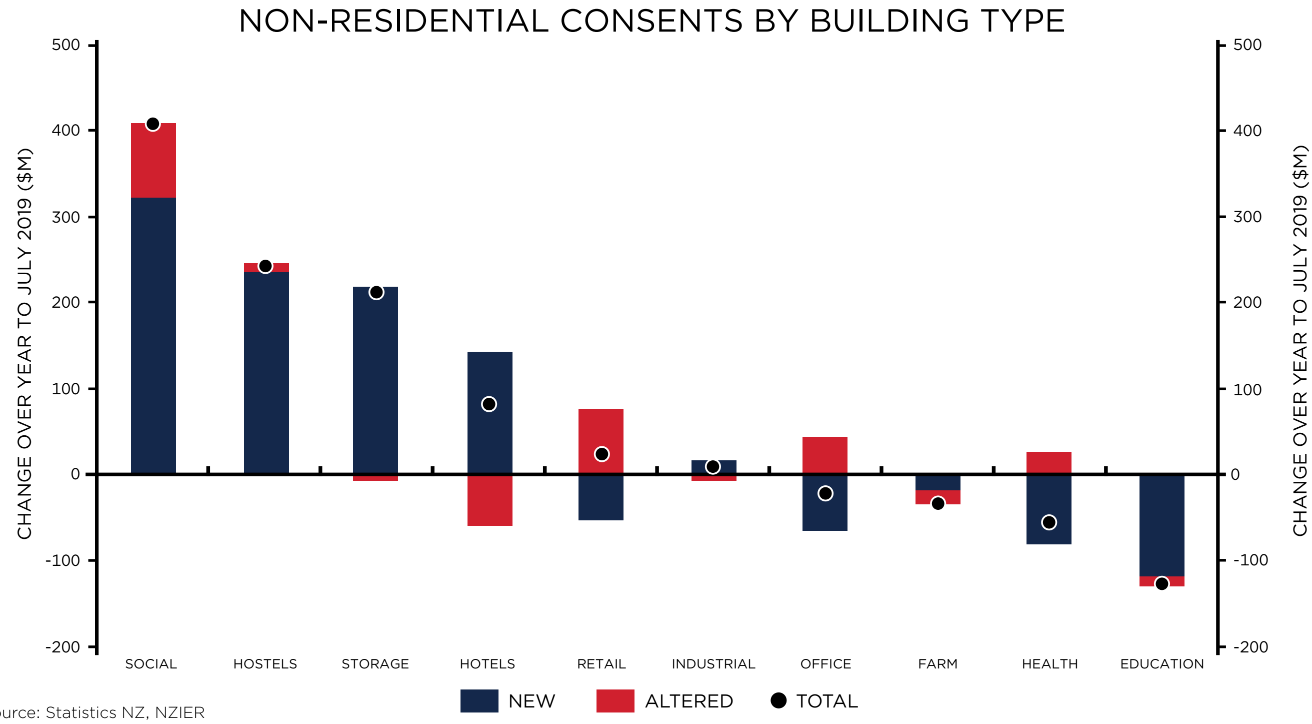
Non-residential construction costs still high



Source: Statistics NZ, NZIER

FIGURE 6

Demand for social buildings drive non-residential construction demand



Source: Statistics NZ, NZIER

TABLE 1

Non-residential building consents by region and sector

$m of consents for the year ending July 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	1.9	1.8	8.4	24.6	20.7	21.0	13.3	11.6	33.0	20.0
AUCKLAND	122.1	217.6	172.4	348.7	325.5	564.3	472.3	528.4	249.0	34.9
WAIKATO	74.2	29.5	37.4	73.4	65.1	53.4	63.0	71.5	113.6	99.7
BAY OF PLENTY	0.0	10.5	61.3	31.9	34.2	83.7	36.5	69.2	42.5	14.8
GISBORNE	0.1	0.1	0.1	9.1	1.4	2.8	2.0	4.1	1.5	2.6
HAWKE'S BAY	9.9	3.8	16.9	18.0	16.0	20.0	16.3	16.4	19.4	8.0
TARANAKI	0.0	4.6	2.3	15.8	7.3	11.2	29.5	9.9	17.6	14.6
MANAWATU-WANGANUI	5.8	6.4	9.1	30.0	14.7	10.3	32.0	21.0	24.0	20.6
WELLINGTON	6.5	8.5	55.8	67.9	128.9	44.2	166.2	23.3	64.6	9.3
NELSON	0.0	0.1	27.3	6.1	0.4	8.7	5.7	2.0	6.8	0.1
TASMAN	0.8	5.5	0.6	6.6	1.5	5.6	3.5	8.2	6.3	1.8
MARLBOROUGH	7.9	2.6	0.2	3.8	2.2	11.9	1.2	1.2	16.7	7.4
WEST COAST	0.0	1.6	1.0	2.1	2.6	4.1	2.7	0.3	8.7	4.0
CANTERBURY	154.0	68.3	71.6	353.1	424.0	137.3	116.0	206.9	92.7	47.9
OTAGO	5.4	83.8	28.0	41.6	19.3	29.1	30.5	16.5	45.2	26.3
SOUTHLAND	1.0	1.1	4.5	4.7	1.4	41.2	3.8	9.5	20.9	10.6

Source: Statistics NZ, NZIER

Wellington Control Tower (Airways NZ), 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.

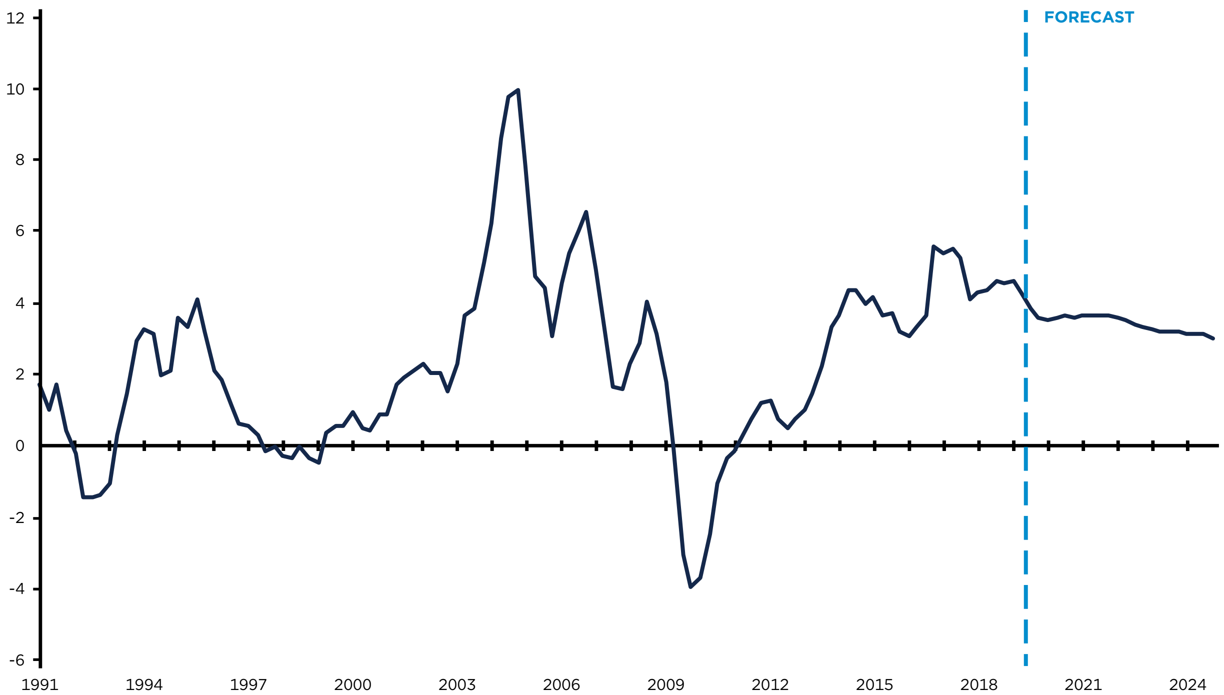
The Rider Levett Bucknall Third Quarter 2019 Oceania Report provides local regional comment and tender price relativity between the main New Zealand and Australian centres. This publication is available at www.rlb.com or on request from any Rider Levett Bucknall office.

We continue to forecast construction cost inflation will fall to below 4 percent over the second half of 2019 before moderating to 3 percent by the end of 2024, as capacity pressures in the construction sector eases gradually.

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	1777	0.8	3.8
	DECEMBER	1793	0.9	3.6
2020	MARCH	1809	0.9	3.5
	JUNE	1825	0.9	3.6
	SEPTEMBER	1841	0.9	3.6
	DECEMBER	1858	0.9	3.6
2021	MARCH	1875	0.9	3.6
	JUNE	1892	0.9	3.7
	SEPTEMBER	1909	0.9	3.7
	DECEMBER	1926	0.9	3.7
2022	MARCH	1942	0.8	3.6
	JUNE	1958	0.8	3.5
	SEPTEMBER	1974	0.8	3.4
	DECEMBER	1989	0.8	3.3
2023	MARCH	2005	0.8	3.2
	JUNE	2021	0.8	3.2
	SEPTEMBER	2037	0.8	3.2
	DECEMBER	2053	0.8	3.2
2024	MARCH	2069	0.8	3.2
	JUNE	2084	0.8	3.1
	SEPTEMBER	2100	0.8	3.1
	DECEMBER	2115	0.7	3.0

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

RIDER LEVETT BUCKNALL OFFICES

For further information please contact Grant Watkins +64 4 384 9198 or your nearest Rider Levett Bucknall office.

New Zealand

Auckland	+64 9 309 1074
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