SECOND QUARTER 2020

FORECAST REPORT 95

NEW ZEALAND TRENDS IN PROPERTY AND CONSTRUCTION

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FORECAST 95

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

Economy undergoes unprecedented changes

New Zealand has undergone significant changes in recent months, as the COVID-19 outbreak led the government in late March to enforce an Alert Level 4 lockdown of the economy. The containment measures led to a sharp decline in construction activity. As New Zealand moved down alert levels and relaxed restrictions, activity indicators pointed to a pick-up in demand across many industries. But the border remains closed to all but a small number of returning citizens and residents, plus critically essential workers.

Investment demand softening even prior to outbreak

There had been signs investment demand was easing even prior to the lockdown, with weaker business confidence weighing on investment intentions. Banks have also been tightening up access to finance for commercial property and the corporate and institutional sector in preparation for increased capital requirements.

Government brings forward infrastructure spending to support recovery

The softening in private sector construction demand provides an opportunity for the government to support the New Zealand economic recovery ahead with increased infrastructure spending. The government announced at Budget 2020 an additional $3.6 billion in infrastructure spending, on top of the $12 billion announced in PREFU in December.

Reserve Bank also steps in to provide stimulus

The Reserve Bank has also injected stimulus into the New Zealand economy by embarking on quantitative easing. Its Large-Scale Asset Purchases (LSAP) program was introduced to support the government's fiscal stimulus program to ensure its substantial bond issuance program, to fund increased government spending, would not cause severe disruptions in the financial markets.

French Memorial at Pukeahu National War Memorial Park, Wellington

BUILDING ACTIVITY TRENDS

The COVID-19 outbreak has caused significant disruptions, both here in New Zealand and globally. In a rapidly changing environment, the New Zealand Government in late March enforced an Alert Level 4 lockdown of the economy. This saw a closure of non-essential services, and for workers that were able to do so a shift to working from home. The subsequent dwindling of new COVID-19 cases saw New Zealand move down alert levels as the government relaxed restrictions and services could resume. Nonetheless, the outbreak has had an undeniable effect on businesses and households, with the impact being uneven across industries.

The Reserve Bank of New Zealand (RBNZ) estimated the likely direct impact of the containment measures on different industries of the New Zealand economy. The RBNZ estimated a sharp reduction in construction activity under Alert Level 4, with the sector likely to only be able to operate at 19% of its pre-COVID level given the shutdown of non-essential services and the inability for much of the construction sector to work from home. However, activity is estimated to increase to 85% of its pre-COVID level under Alert Level 3 as restrictions are relaxed. While construction activity is likely to be able to operate at close to 100% under Alert Level 1 given the removal of social distancing requirements, construction demand becomes a more dominant influence on the level of activity that takes place.

Recent activity indicators show a rebound in activity as New Zealand moved down the alert levels and restrictions were relaxed. NZTA heavy vehicle traffic count shows a strong rebound in heavy vehicle flows in the wake of the move to Alert Level 1, with transport activity up to around 90% of the levels prior to the outbreak in many of the main centres. Given heavy vehicle flows tends to reflect underlying demand in the economy as it captures the volume of freight being moved around, this rebound points to a recovery in demand in recent weeks.

March quarter Building Work Put in Place showed construction activity fell 5.7% over the quarter. This decline was not surprising given New Zealand entered Alert Level 4 in the last week of the March quarter, and the Reserve Bank had estimated the construction sector could only operate at around 19% of pre-outbreak levels under these lockdown circumstances. The decline was particularly marked in Auckland, where a lot of the growth in construction demand was concentrated in recent years.

Consent issuance provides some indication of the pipeline of construction activity. The lockdown also disrupted the consent issuance process, with issuance falling in March and April. These declines halted the recent run of strong issuance in the preceding months. Demand for multi-unit dwellings such as townhouses and flats has been particularly strong, reflecting the shift towards medium and high-density housing. This trend is likely to continue given the scarcity of centrally located land in the main centres. Nonetheless, stand-alone houses remain the most popular form of new dwelling in New Zealand.

In contrast to residential construction demand, there had been some signs of easing in demand for non-residential construction. Business confidence was already weakening prior to the outbreak, and the March quarter NZIER Quarterly Survey of Business Opinion (QSBO) showed this weighed on investment intentions for buildings. Non-residential construction demand also faced headwinds from a tightening in access to finance, with the RBNZ survey of credit conditions showing banks' reduced appetite to lend for commercial property, corporate and institutional and agriculture sector.

Despite the decline in non-residential construction demand, construction costs appear to be holding up. The average value of consents issued per square metre provides an indication of construction costs, and this has remained steady in recent months even as non-residential construction demand softened.

BUILDING ACTIVITY OUTLOOK

Construction activity rebounded as New Zealand moved down alert levels and consent issuance points to a robust pipeline of construction over the coming year. However, we expect weaker population growth and sharply lower tourist inflows which should reduce demand for house-building activity and hotel developments over the longer term.

It is too early to say whether working from home, which has been widespread through the lockdown, will have any permanent impact on overall demand for office accommodation in city centres.

Banks also remain cautious about lending for commercial property, and the corporate, institutional and agriculture sector in preparation for increased capital requirements. Although the RBNZ in response to the COVID-19 outbreak has delayed the implementation of these increased capital requirements by 12 months to 1 July 2021, banks' appetite to lend to these sectors remains soft.

The lower level of private sector construction activity provides a good opportunity for the government to step in and increase its spending on infrastructure. Capacity pressures in the construction sector in recent years had limited the extent to which infrastructure construction could ramp up. As private sector construction demand softens, this should free up some capacity in the sector and allow the government to increase its infrastructure investment.

As part of Budget 2020, the government established a $50 billion COVID-19 Response and Recovery Fund (CRRF). Approximately $30 billion of spending from the CRRF has been committed, with $20 billion still available. The government announced at Budget 2020 an additional $3.6 billion in infrastructure spending, on top of the $12 billion announced in Half Year Economic and Fiscal Update (HYEFU) in December 2019. The government also subsequently announced plans to fast-track the consenting process of some infrastructure projects in order to support the recovery of the New Zealand economy.

ECONOMIC BACKDROP

There is a large degree of uncertainty over the New Zealand economic outlook as a result of the COVID-19 outbreak. Although the move of New Zealand down the alert levels and relaxation of restrictions have been at the optimistic end of the range of scenarios considered by the government at the early part of the lockdown, significant risks remain. Many of these risks stem from things beyond the control of New Zealand, including how the rest of the world fares in eliminating COVID-19, and how governments and central banks in other major economies respond. These in turn influence how long border restrictions are likely to be in place, and the demand for New Zealand exports.

The pandemic continues to spread through the world, with increasing levels of infection in both new areas, and places that had seen falls in infection rates. Whether this is a 'second wave' or a continuation of the first remains unclear.

While there are few restrictions on domestic economic activity at COVID-19 Alert Level 1, the border remains closed to all, bar a few returning citizens and residents, and critically essential workers. We expect these restrictions to remain in place until a vaccine or effective treatment is developed, which could be over a year away. Even the prospects of a 'trans-Tasman travel bubble' have receded, with recent surge in cases in Victoria seeing interstate travel restrictions in Australia remaining in place.

The closing of the border will have immediate effects in terms of slowing both population growth and tourism expansion. It will also limit the ability of the construction sector to bring in migrants to assist with resources for projects.

Besides the devastating impact of the outbreak on our services exports such as tourism and international education, the impact on demand for New Zealand commodity exports has been modest and varied. Weekly trade data shows that since the beginning of February, exports of dairy, meat and fruit have increased relative to the same period a year ago. In contrast, forestry, seafood and non-food manufacturing exports declined over that same period.

The divergent changes in demand for the different types of New Zealand goods' exports highlights the uneven effects of COVID-19 on the global economy. People around the world are focusing their spending on necessities such as food, from which New Zealand being a major producer of meat and dairy is well-placed to meet.

INTEREST AND EXCHANGE RATES

The government and Reserve Bank has launched an unprecedented amount of stimulus in response to the effects of the COVID-19 outbreak. This included the cutting of the OCR by the Reserve Bank to a new historic low of 0.25%, as well as quantitative easing in the form of a $60 billion Large Scale Asset Purchase Program. These measures are aimed at keeping interest rates low across the curve to encourage households and businesses to spend and invest.

Although New Zealand looks to be at the optimistic range of scenarios outlined by The Treasury at the start of the lockdown when it comes to time spent at each alert level, the Reserve Bank highlighted the downside risks that remain to the economic outlook. These risks mean further stimulus are likely over the coming year, with the potential for a negative OCR sometime next year should economic conditions deteriorate.

The willingness of the Reserve Bank to loosen monetary policy further over the coming year put downward pressure on the New Zealand dollar.

BUILDING INVESTMENT

Consent issuance points to a robust pipeline of construction in the near term, particularly for housing. Beyond 2020, weaker population growth and lack of tourist inflows in 2021 should dampen demand for new housing and accommodation. This reduction in private sector construction demand provides an opportunity for the government to step in with increased infrastructure investment to support the recovery of the New Zealand economy.

BUILDING CONSENTS

Consent issuance declined over March and April largely because of the disruptions from the lockdown. Prior to that, residential consent issuance had been robust reflecting the effects of the strong population growth of recent years. In contrast, businesses were already starting to be cautious about investment in buildings.

Building consents by sector

Looking at the trends over the past year, accommodation buildings remained the top driver behind the increase in non-residential consent issuance. This reflected the effects of strong population growth and tourist inflows in recent years.

In contrast, demand for social buildings, education facilities and retail outlets dropped sharply over the past year. The short- and long-term effects on universities resulting from the significant reduction in international student numbers are still to be determined, and will depend to some extent on how long border restrictions are in place.

The Alert Level 4 lockdown has seen people adapt to working from home and shopping online. As restrictions were relaxed people have returned to work and the shopping malls, but many have chosen to work from home for at least part of the week. Whether these changes in behaviour will become permanent will determine longer-term demand for office buildings and retail outlets. The factors driving demand for office space is mixed. While some businesses may look to cut costs by requiring workers to remain working from home, or in cheaper and less central locations, some may require more office space given social distancing preferences and risks of contagion from activity based working.

Reduced commuting into the central business districts may shift demand for retail space out into the suburbs.

Although banks are more cautious about lending in the agriculture sector as a result of the upcoming implementation of increased capital requirements, the increased global demand for New Zealand dairy, meat and fruit should drive demand for new farm buildings over the longer term.

Building consents by region

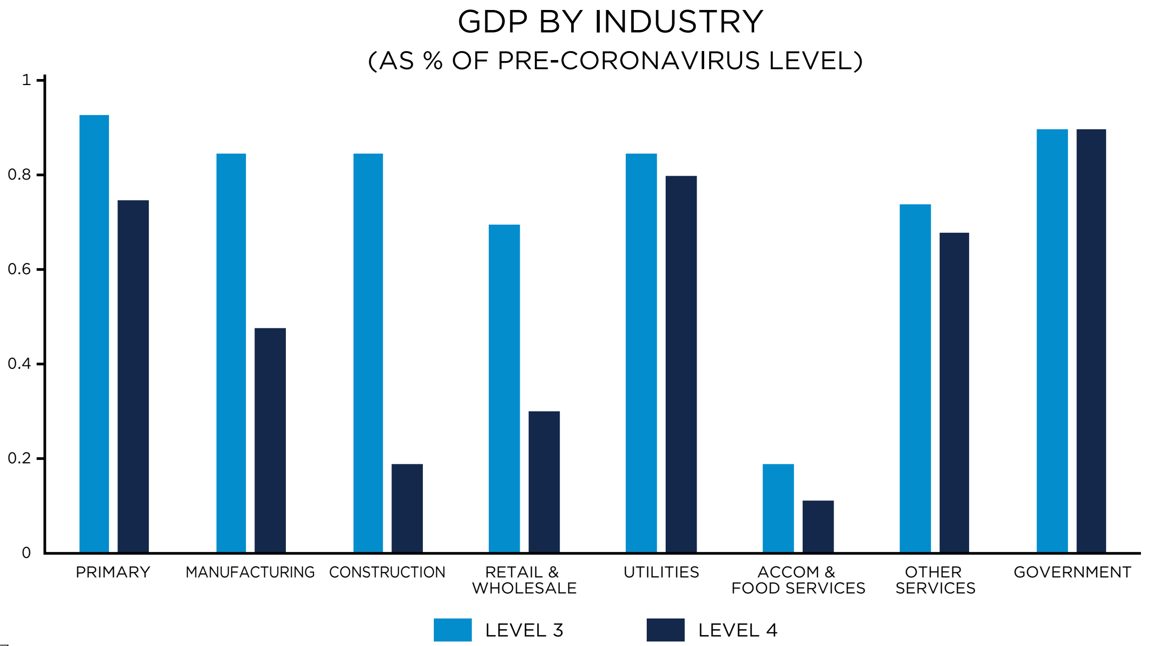
Non-residential construction demand has fallen sharply in Auckland and Canterbury over the past year. In Auckland, this was largely driven by reduced demand for retail outlets, social buildings and education facilities. In Canterbury, weaker demand for social buildings drove the decline in non-residential construction consent issuance.

Non-residential construction demand in the Bay of Plenty was also lower over the past year, reflecting broad-based weakness across the sectors. Border restrictions will have a negative impact on its tourism sector. However, there should be some offset on activity in the Bay of Plenty from increased global demand for fruit exports, which the region, as a key producer of kiwifruit, should be well-placed to meet.

In contrast, non-residential construction demand increased in Otago over the past year. This increase was on the back of stronger demand for accommodation and retail outlets. Given tourism makes up a substantial proportion of the Otago economy, we expect border restrictions will have a negative impact on non-residential construction demand over the coming year.

FIGURE 1

Alert Level 4 lockdown reduced construction activity sharply

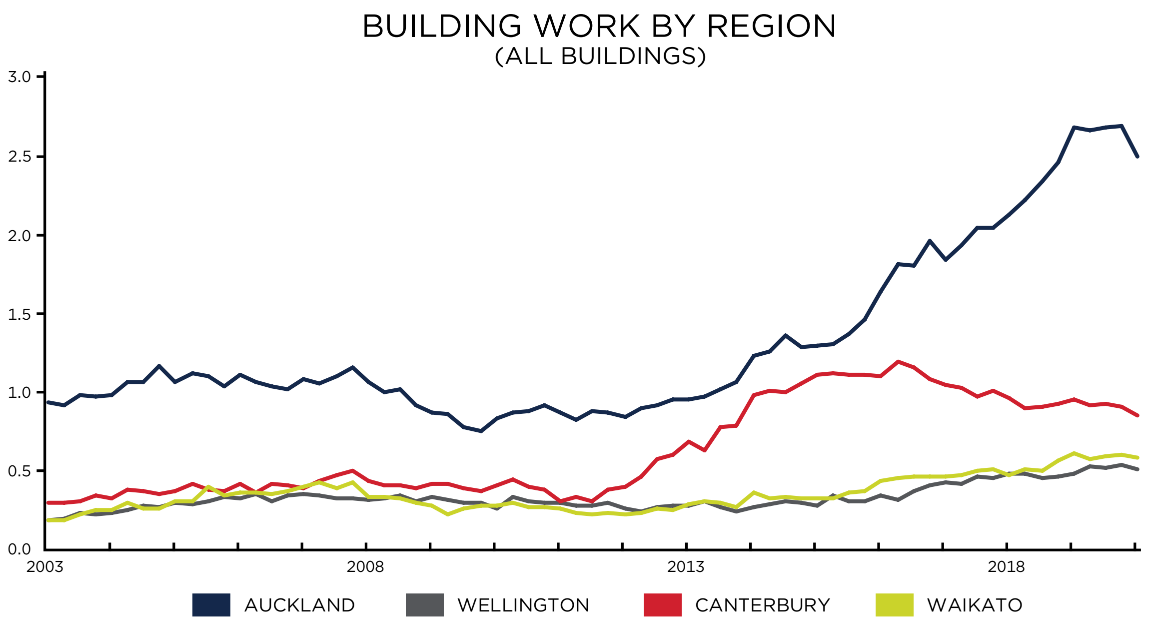


Source: RBNZ

FIGURE 2

Construction declines across the regions

Quarterly, seasonally adjusted ($billions)

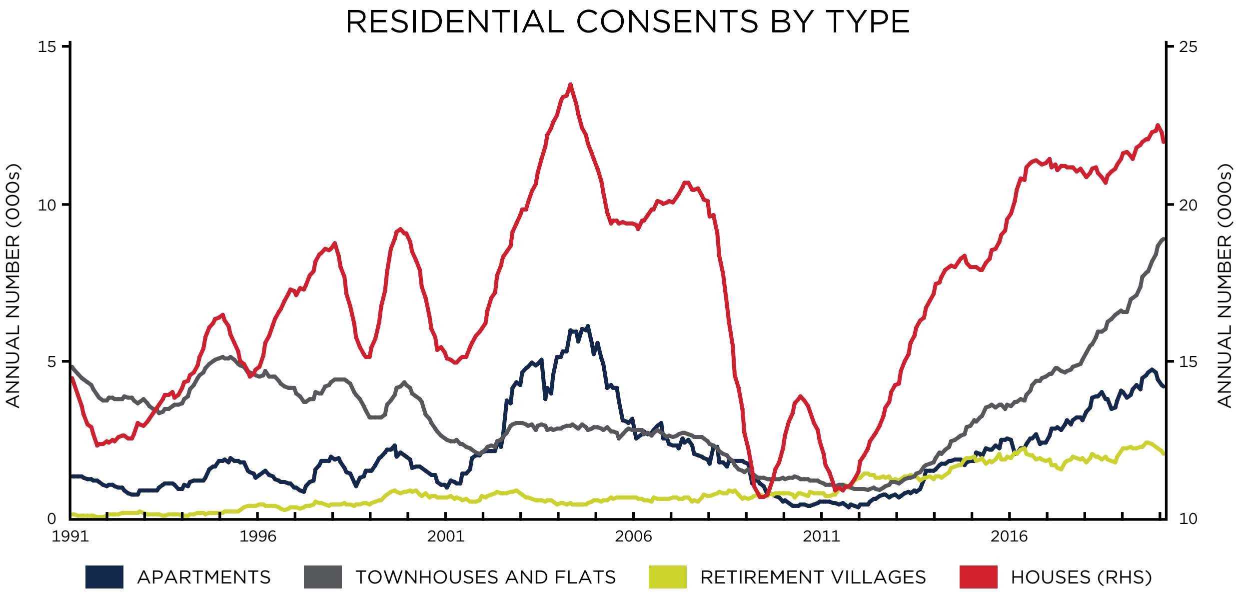


Source: Statistics NZ

FIGURE 3

Lockdown also affects consent issuance

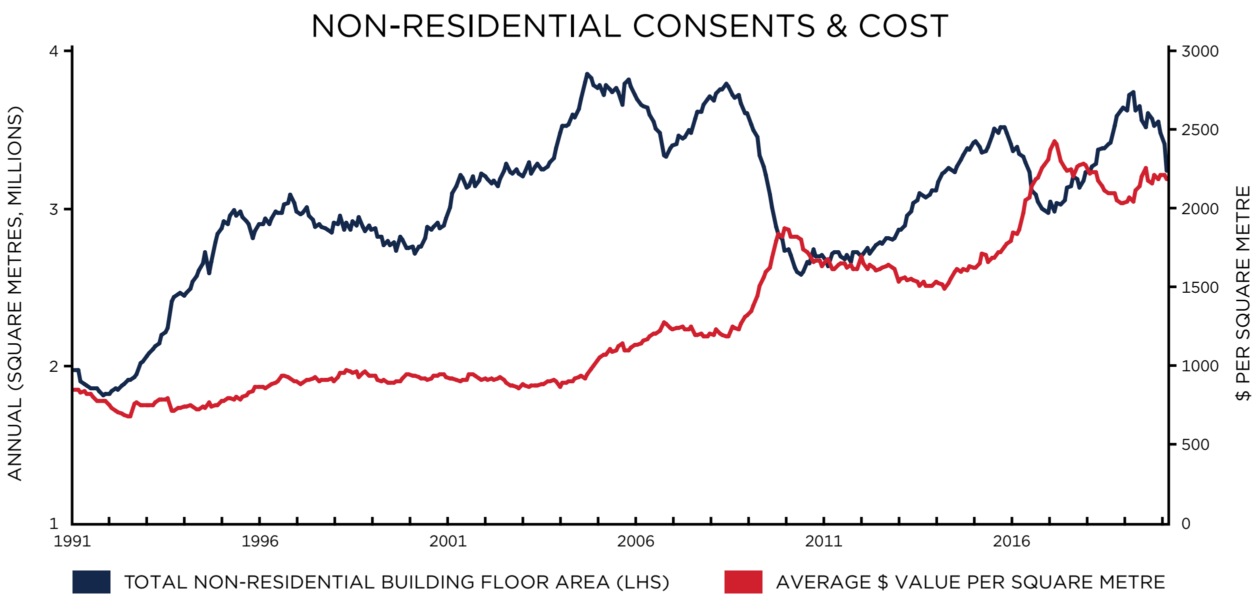
Annual (000s)



Source: Statistics NZ

FIGURE 4

Construction cost escalation holding up for now

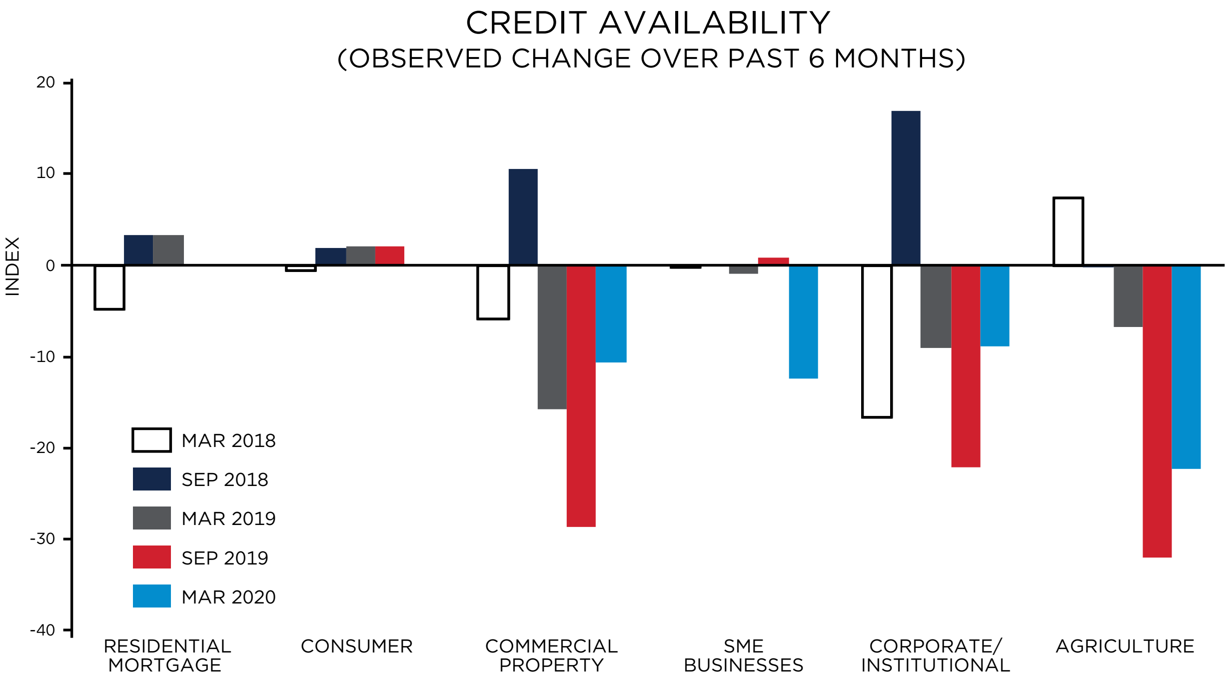


Source: Statistics NZ

FIGURE 5

Continued caution amongst banks towards lending

Banks' observed change over the past 6 months

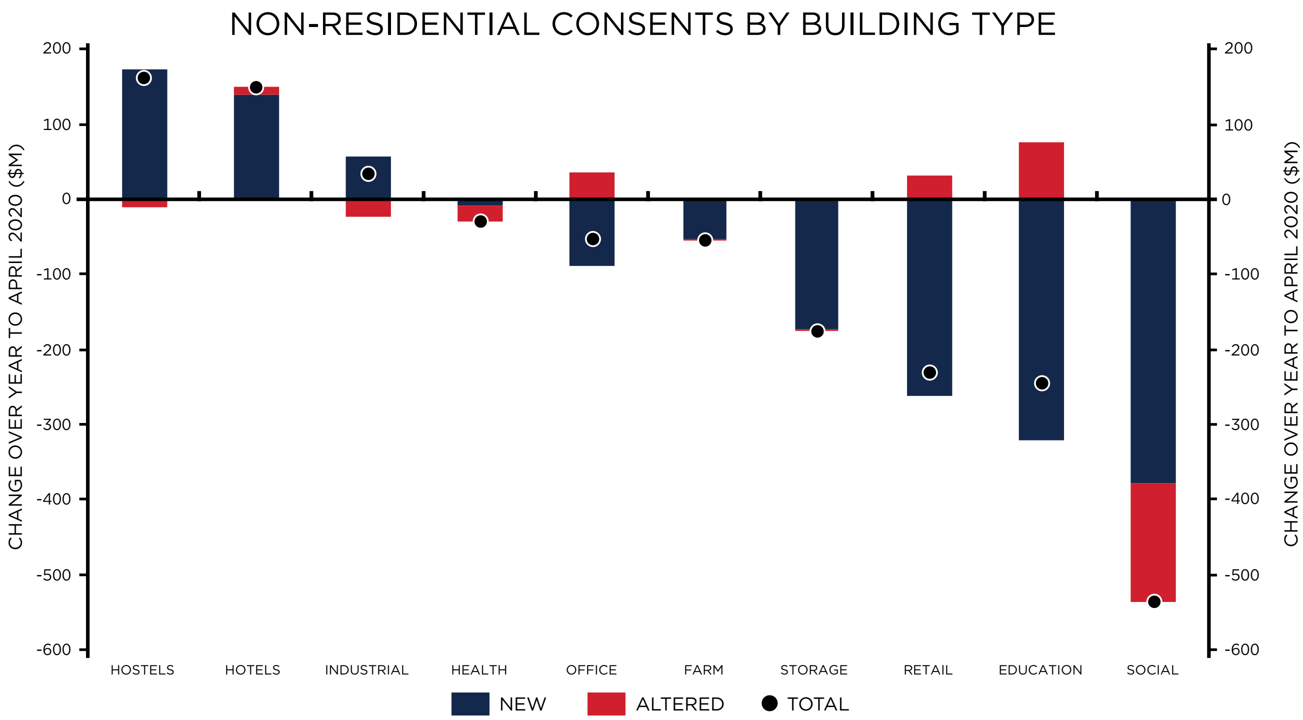


Source: RBNZ

FIGURE 6

Sharp drop in demand for education and social buildings

Change over year to April 2020



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	0.7	11.9	21.0	19.7	11.0	17.7	8.1	26.3	18.7
AUCKLAND	99.5	294.2	174.7	356.1	135.3	399.6	421.2	417.3	191.3	27.5
WAIKATO	111.4	9.1	30.7	63.2	34.1	89.6	77.6	68.0	142.2	70.6
BAY OF PLENTY	12.6	10.9	10.3	25.2	17.9	52.0	41.8	36.9	54.5	14.2
GISBORNE	0.2	0.1	0.1	9.6	1.3	16.0	2.4	5.6	2.9	3.0
HAWKE'S BAY	7.9	5.6	38.6	33.7	5.6	23.8	14.6	25.1	16.2	11.9
TARANAKI	0.0	2.5	1.0	21.0	4.1	10.2	18.5	5.7	13.2	10.5
MANAWATU-WANGANUI	10.5	10.4	17.6	40.6	16.3	22.9	10.3	9.1	15.1	17.3
WELLINGTON	46.7	6.3	57.2	59.2	101.8	52.8	184.9	65.1	48.5	8.7
NELSON	0.0	0.0	13.2	2.5	0.1	9.4	3.4	2.0	6.7	0.5
TASMAN	1.3	1.3	3.8	5.6	0.5	9.2	2.9	3.6	13.4	1.5
MARLBOROUGH	11.6	6.6	0.0	5.0	6.0	8.4	3.3	5.6	23.5	4.0
WEST COAST	0.0	1.0	0.0	2.0	1.7	4.7	3.8	0.5	1.7	4.2
CANTERBURY	93.8	80.2	87.4	184.1	147.7	105.2	52.6	125.1	118.9	36.2
OTAGO	3.5	177.9	22.1	64.3	25.4	82.1	29.6	44.0	46.9	19.9
SOUTHLAND	0.1	10.5	3.3	5.7	4.2	23.6	10.9	4.1	14.4	15.5

Source: Statistics NZ, NZIER

Waitohi, Johnsonville library, 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. This is particularly the case in the rapidly changing environment, with the expected shift from private sector construction demand to public sector infrastructure investment likely to cause substantial variances across different types of building work.

The Rider Levett Bucknall First Quarter 2020 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.

Non-residential construction cost escalation showed signs of moderation in the March 2020 quarter. The sharp decline in construction activity in the midst of the COVID-19 outbreak will have varying effects on construction costs. As detailed in the Rider Levett Bucknall New Zealand Construction Market and Escalation Forecast, weaker demand, increased capacity and cashflow pressures should weigh on construction costs.

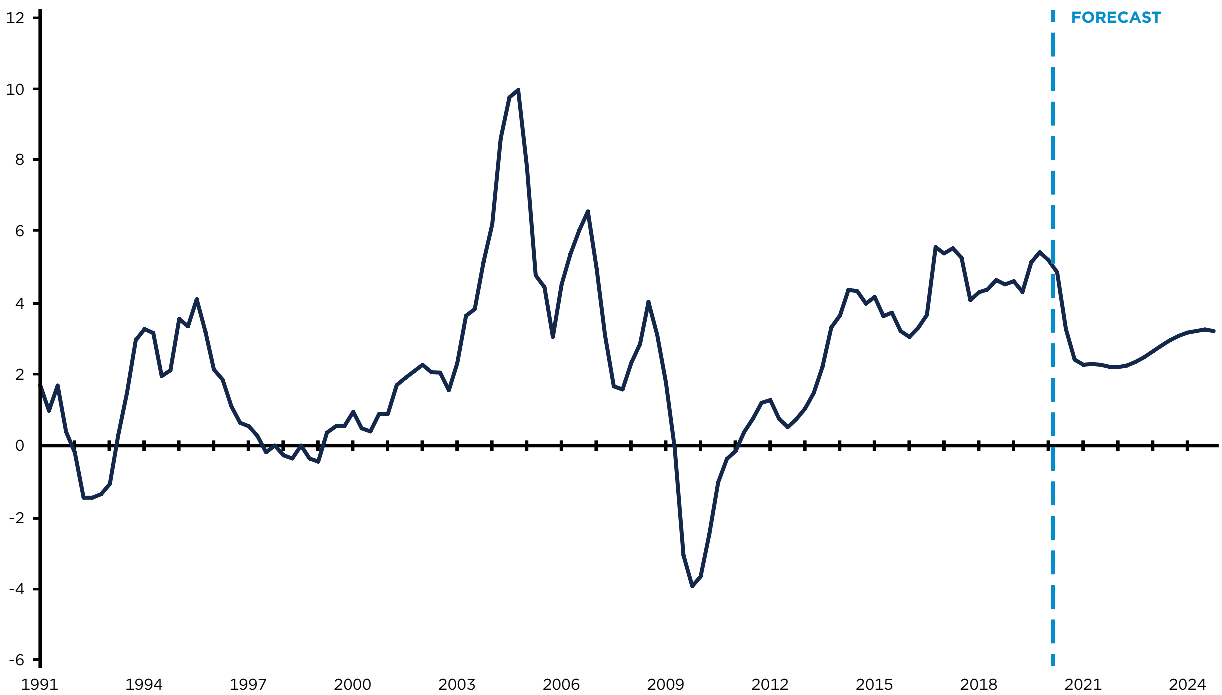
However, there may be some offset from increased costs from compliance and risks, as well as supply chain disruptions. Reduced labour supply as people exit the construction workforce may also lead to increased construction cost escalation. Which of these factors dominate will determine the construction cost outlook.

Recognising the higher than usual uncertainty over forecasting in these times, we expect on balance a sustained period of soft construction cost escalation. We forecast annual construction cost inflation to ease below 2.5% by the end of this year, and track just over 2% through to 2022. Beyond that, as supply adjusts to the weaker demand we expect a pick-up in construction cost escalation towards 3%.

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	1825	1.4	5.4
2020	MARCH	1838	0.7	5.2
	JUNE	1848	0.5	4.9
	SEPTEMBER	1858	0.6	3.3
	DECEMBER	1869	0.6	2.4
2021	MARCH	1880	0.6	2.3
	JUNE	1890	0.5	2.3
	SEPTEMBER	1900	0.5	2.3
	DECEMBER	1910	0.5	2.2
2022	MARCH	1921	0.6	2.2
	JUNE	1932	0.6	2.2
	SEPTEMBER	1945	0.6	2.3
	DECEMBER	1958	0.7	2.5
2023	MARCH	1972	0.7	2.6
	JUNE	1987	0.8	2.8
	SEPTEMBER	2002	0.8	3.0
	DECEMBER	2018	0.8	3.1
2024	MARCH	2034	0.8	3.2
	JUNE	2051	0.8	3.2
	SEPTEMBER	2067	0.8	3.3
	DECEMBER	2083	0.8	3.2

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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