THIRD QUARTER 2020

FORECAST REPORT 96

NEW ZEALAND TRENDS IN PROPERTY AND CONSTRUCTION

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FORECAST 96

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

COVID-19 continues to be a major influence on the New Zealand and international economies. Net migration, which had previously been a key driver of population growth and hence residential accommodation demand, has virtually stopped. In the six months to September, net migration of all citizenships was 2,500, compared with an average of over 20,000 in the same period in recent years.

Confidence and demand improving as economy responds to stimulus

Nonetheless, there are signs that confidence and demand in New Zealand is picking up, as the economy responds to the unprecedented amount of stimulus measures implemented by the government and the Reserve Bank. These measures include the wage subsidy scheme, lower interest rates, and increased government spending on infrastructure. The rebound in activity suggests a v-shaped recovery for the New Zealand economy.

Lower interest rates boost demand for housing

The decline in mortgage rates is supporting a rebound in housing market activity, with house prices rising across the regions. New lending on housing is strong, in contrast to the contraction in consumer credit as households remain cautious about discretionary spending.

Construction sector feeling positive as government increases spending on infrastructure

The latest NZIER Quarterly Survey of Business Opinion shows the construction sector has turned from the most pessimistic to the most optimistic sector surveyed. Construction sector firms have been buoyed by the improving pipeline of construction, particularly for government work as the government increases spending on infrastructure.

Reserve Bank continues to loosen monetary policy

The Reserve Bank has introduced additional stimulus measures, including the announcement of a Funding for Lending Programme (FLP) which provides banks with funding at near the OCR. Along with the Large-Scale Asset Purchase (LSAP) programme and lower OCR, these measures are designed to lower borrowing costs to encourage households and businesses to spend and invest. We expect the Reserve Bank will introduce a negative OCR around the middle of next year.

University of Waikato, Tauranga Campus

BUILDING ACTIVITY TRENDS

After a severe contraction in economic activity in the June quarter, largely reflecting the containment measures put in place under Alert Level 4 lockdown in late March, there are signs of a rebound in demand and sentiment. The latest NZIER *Quarterly Survey of Business Opinion* (QSBO) showed a net 1 percent of businesses reporting increased demand in the September quarter – a turnaround from the net 37 percent reporting reduced demand in the previous quarter. Although businesses overall were still feeling pessimistic about the general economic outlook, this pessimism was fading.

The history of business confidence surveys shows that business confidence tends to decline heading into a general election, reflecting uncertainty about the election outcome and what that would mean for the economic outlook. This uncertainty makes firms cautious about committing to investment, with the reduction in demand in turn weighing on confidence further. The latest QSBO was taken just before the general election on 17 October, and it is encouraging to see confidence already starting to recover even prior to the election outcome being known.

The recovery in sentiment was particularly strong in the construction sector, with the sector turning from the most pessimistic to the most optimistic of the sectors surveyed. A net 7 percent of construction sector firms expect an improvement in the economy over the coming months – a sharp turnaround from the net 75 percent expecting a deterioration in the previous quarter. Stronger domestic demand is supporting this lift in confidence, with firms reporting higher orders and output.

Record low mortgage rates have underpinned a surge in housing market activity as New Zealand moved down the alert levels and lockdown restrictions were lifted. House prices surged against the backdrop of strong demand and tight supply. This increase in house prices has encouraged new housing supply to come on board, with demand for residential construction picking up. Building consent issuance shows that the increase in residential construction demand has been concentrated in medium-density housing, with issuance for townhouses and flats rising sharply over the past year. Although standalone houses remain the most popular type of new dwelling, demand has plateaued. Meanwhile, demand for apartments has weakened.

The shift in demand towards medium-density housing reflects the shortage of centrally located land, which reduces the financial feasibility of standalone houses. On the other hand, banks' increased caution towards lending for commercial property and to the corporate sector is weighing on demand for the construction of large-scale apartment complexes. Although border restrictions have meant a sharp decline in net migration inflows, the strong migration-led population growth in recent years has meant a shortage of housing which the construction sector is continuing to fill. We expect the continued low-interest rate environment will underpin strong demand for residential construction over the coming years.

The NZIER QSBO measure of architects' work in their own office points to a growing pipeline of construction, particularly when it comes to government work. The government in July announced a $3 billion COVID Response and Recovery Fund to support the New Zealand economy's recovery through the COVID-19 outbreak. This spending included $180 million ear-marked for large-scale construction projects, with other spending in the fund allocated to address climate resilience, transformative energy and regional digital connectivity.

The increased government spending on infrastructure is underpinning the strong rebound in construction demand. This rebound is flowing through to increased demand for workers in the construction sector, with the September quarter labour market data release showing increased employment in the construction, healthcare and education sectors. This increase was in stark contrast to the decline in employment in the accommodation and hospitality, and administration services. These shifts in employment demand highlight the uneven nature of the effects of the COVID-19 outbreak across the sectors of the New Zealand economy.

BUILDING ACTIVITY OUTLOOK

Consent issuance and business surveys point to a healthy recovery in the pipeline of construction for the coming year. Construction demand is improving across the sectors and is particularly strong in government and residential work. We expect continued low-interest rates and the government's focus on supporting the economy through the post-COVID recovery will underpin strong demand for construction over the coming years.

Across the regions, non-residential construction demand has picked up in Auckland in recent months following large declines earlier in the year. Demand in Waikato and Wellington is also picking up, with increased demand for office buildings driving the stronger non-residential construction demand in Wellington over the past year.

In contrast, non-residential construction demand in Canterbury continues to fall sharply. This reflects a broad-based decline across the sectors with only consent issuance for healthcare buildings increasing in Canterbury over the past year.

We expect non-residential construction demand will continue to pick up in Auckland over the coming year, provided there are no further community outbreaks which require lockdown restrictions to be implemented. Demand in the region has rebounded, as reflected in the pick-up in heavy vehicle traffic flows which provide a good indication of the freight being transported.

Nonetheless, we expect that continued uncertainty over how the COVID-19 outbreak will play out will keep businesses cautious when it comes to new investment. This should continue to weigh on non-residential construction demand. We expect government construction work will continue to lead the growth in construction demand over the coming years, as the government increases its spending on infrastructure to support the recovery ahead.

The government in July outlined how $3 billion of the COVID Response and Recovery Fund allocated for the regions will be spent, including $464 million on housing and urban development and $180 million on large-scale construction projects. The increased pipeline of construction activity should support employment demand and see a re-emergence in capacity pressures in the construction sector from late 2021, particularly if continued border restrictions limit the ability for migrants to be brought in to assist with resources for projects.

ECONOMIC BACKDROP

Although business confidence is improving, there remains some uncertainty over the New Zealand economic outlook. The announcement of community transmission of COVID-19 in August which led to lockdown restrictions again being imposed in Auckland highlighted just how quickly conditions can change. This uncertainty makes it hard for businesses to plan and invest, and a degree of caution remains.

With the COVID-19 outbreak still rampant in major countries overseas, border restrictions look likely to be in place heading into 2021.

We have already seen a large reduction in net migration, with the most recent Statistics New Zealand release showing that for the six months to September, net permanent and long-term migration of all citizens was only 2,500. This was made up of a net gain of 7,200 New Zealand citizens, and a net loss of 4,700 non-New Zealand citizens. This compares with an average of approximately 20,000 in the same period in recent years.

While there are encouraging signs that a vaccine against COVID-19 may start to be rolled out soon, logistical obstacles to widespread vaccination globally are large. Border restrictions are likely to remain in place for a considerable period. Even the much-anticipated trans-Tasman travel bubble has been delayed until at least after the coming summer peak season. We expect that economic activity in tourism-exposed industries such as accommodation and hospitality will continue to be severely restricted.

In contrast, export demand for dairy, meat and fruit remains robust. This changing shift in demand towards food-based production highlights the uneven effects of the COVID-19 outbreak on the global economy, as people focus spending on necessities.

Nonetheless, the pick-up in demand and confidence points to a v-shaped recovery for New Zealand, as the economy responds to the unprecedented amount of stimulus measures implemented by the government and the Reserve Bank. While there remains a large degree of uncertainty over whether there will be any further community transmissions which will require lockdown restrictions to be imposed again, the outlook overall is for a continued recovery in the economy.

INTEREST AND EXCHANGE RATES

The Reserve Bank has implemented a raft of measures designed to lower borrowing costs across the curve in order to encourage businesses and households to spend and invest in the wake of the COVID-19 outbreak. These measures include cutting the OCR, introducing quantitative easing through its $100 billion Large Scale Asset Purchase (LSAP) Programme and implementing a Funding for Lending Programme (FLP) to enable banks to access funding at near the OCR to encourage them to pass on lower borrowing costs to their customers. The Reserve Bank has also indicated the potential for a negative OCR to be introduced next year.

These measures have led to a sharp decline in interest rates, with record low mortgage rates driving a surge in house sales. Lower interest rates have also boosted sharemarkets as investors seek yield.

Improving risk appetite is the dominant influence underpinning New Zealand dollar strength in recent months, despite the Reserve Bank's dovish stance and indication of a negative OCR next year. We expect the NZD/USD will ease to around 65 cents over the coming year as renewed confidence about the US economic outlook underpins USD strength.

BUILDING INVESTMENT

Consent issuance points to a robust pipeline of residential construction, but the outlook for non-residential construction is mixed. Strong house price growth is encouraging the construction of new dwellings now. However, we expect weaker population growth as a result of the border restrictions over much of 2020 will mean weaker housing demand over the longer term, which should flow through to residential construction demand. Meanwhile, banks' caution about lending for commercial property and to the corporate sector will likely weigh on private sector non-residential construction over the coming year.

BUILDING CONSENTS

Non-residential consent issuance recovered as New Zealand moved down the alert levels and lockdown restrictions were relaxed. Although issuance is at higher levels than a year ago, on an annual basis it has yet to make up for the sharp declines over the March to May months. This reflects the caution that remains in regard to investment in buildings.

Building consents by sector

The trends over the past year reflect the uneven impact of the COVID-19 outbreak on the economy. Border restrictions have had a particularly negative impact on sectors exposed to tourism such as accommodation and retail, and this is flowing through to construction demand in these sectors.

Although consumer confidence is recovering, the growing popularity of online shopping, particularly with the enforcement of lockdown and social distancing restrictions, has reduced demand for bricks and mortar shops over the longer term. This shift towards online shopping has increased demand for storage facilities over the past year. We expect online shopping will drive a continued shift in construction demand from retail outlets towards storage facilities over the coming years. A shift to working from home for at least some days of the week for many office workers may also shift the geographic distribution of retail outlets from the inner city to the outer suburbs.

Demand for healthcare facilities has also increased, reflecting the shift in focus towards healthcare during the pandemic. The ageing population also means that demand for healthcare facilities should remain robust over the longer term.

Meanwhile, demand for office space declined as workers in professional services adapted to working from home in the wake of the lockdown restrictions under Alert Levels 3 and 4.

Although demand for farm buildings eased over the past year, the global shift in demand towards food-based production should drive a rebound in demand for farm buildings over the coming years. Banks are less cautious about lending to the agriculture sector in the face of the improved outlook for farmgate returns.

Building consents by region

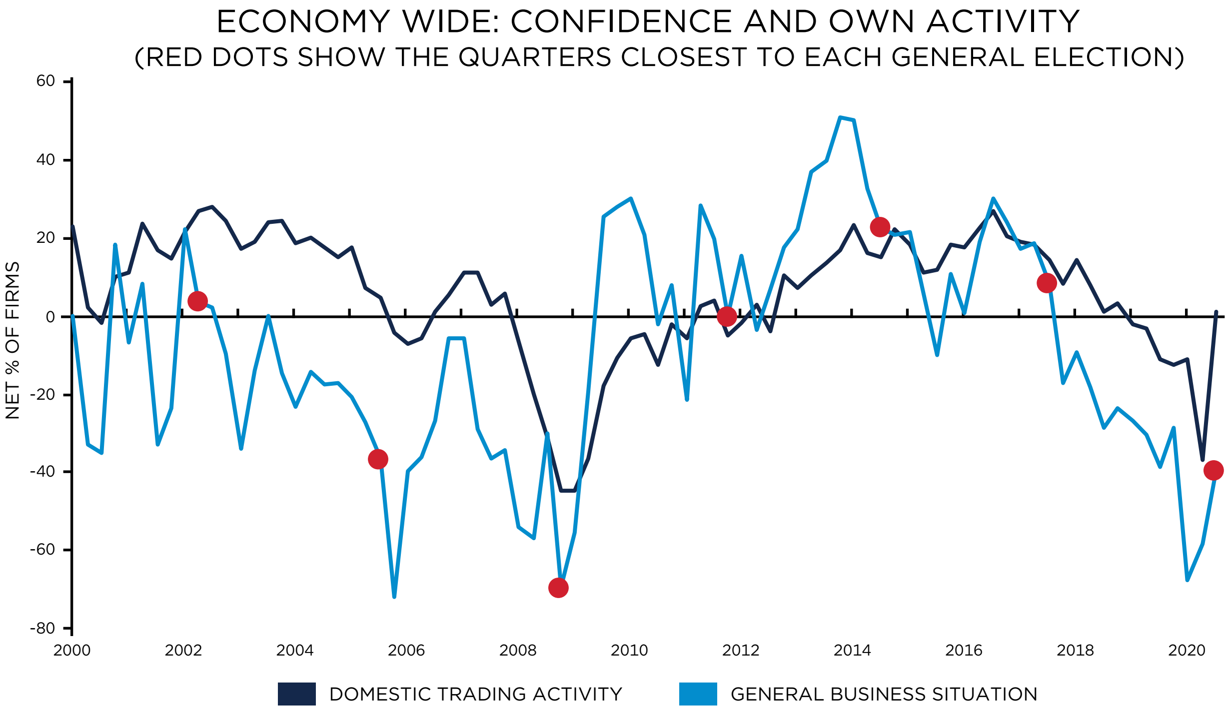
Although non-residential consent issuance in Auckland picked up strongly in recent months, it has yet to make up for the sharp decline over the first half of 2020. Weaker non-residential construction demand in the region over the past year was spread across retail outlets, social buildings and office space. However, there was a surge in Auckland office consent issuance in September. The increase in vacancy rates across both prime and secondary grade office space points to reduced demand for Auckland office building construction over the coming years. However, we expect non-residential construction demand in the other Auckland sectors will pick up over the coming years in line with the recovery in activity more broadly.

Non-residential consent issuance has been particularly strong in Wellington over the past year. This growth was driven by stronger demand for the construction of office (particularly in June), storage and social buildings. The dominance of the public sector in Wellington means that vacancy rates for office space remains low relative to the other regions, and that should underpin continued demand for office construction.

In contrast, non-residential construction demand in Canterbury continued to fall sharply over the past year, reflecting broad-based weakness across the sectors. There was a particularly large decline in demand for the construction of education and social buildings. We expect the effects of the COVID-19 outbreak will weigh on Canterbury non-residential construction demand over the next year, particularly in areas exposed to tourism.

FIGURE 1

Business confidence and demand improves

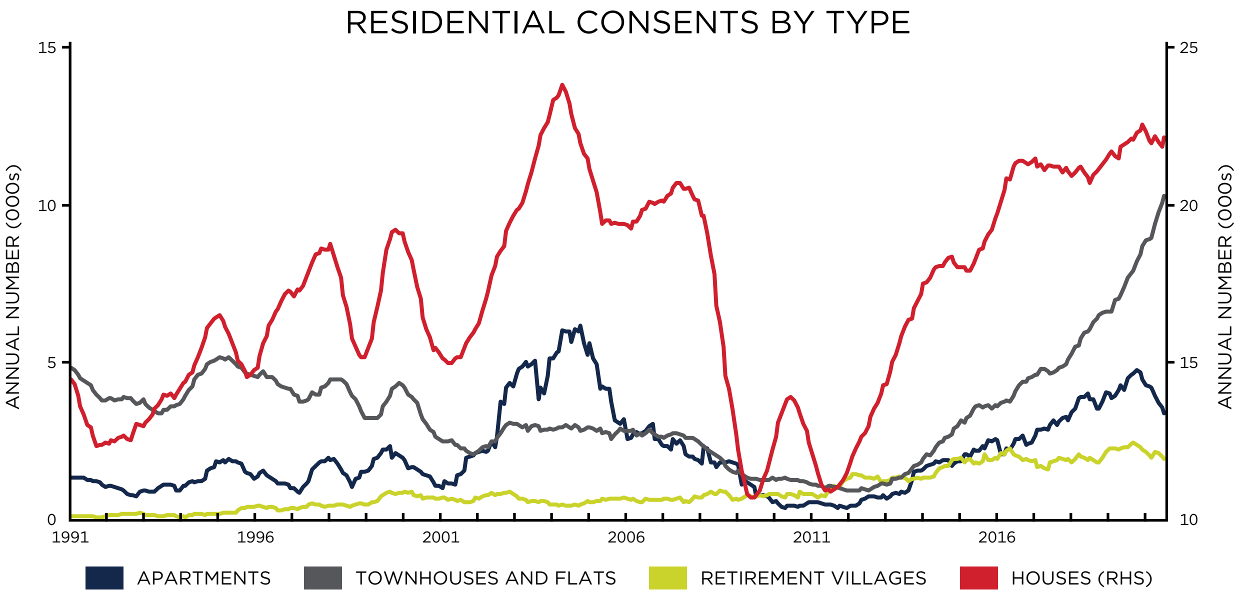


Source: NZIER

FIGURE 2

Strong demand for medium-density housing

Annual number of consents, thousands

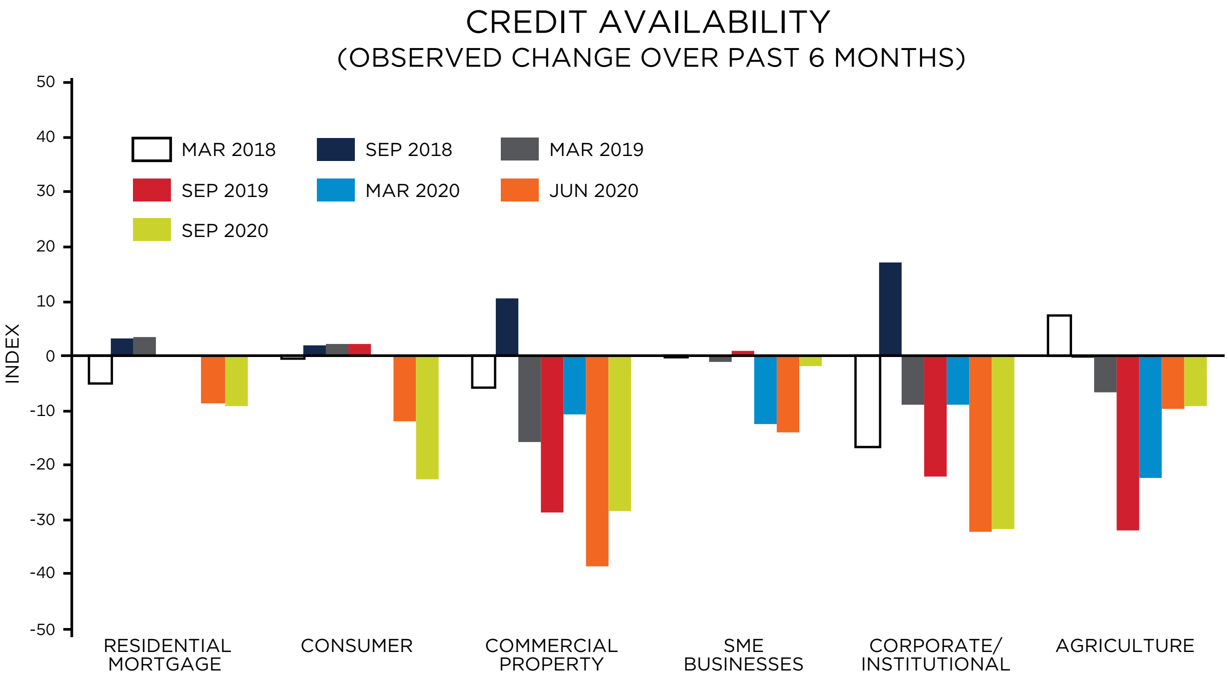


Source: Statistics NZ

FIGURE 3

Banks remain cautious about lending to corporate sector

Banks' observed change over the past 6 months

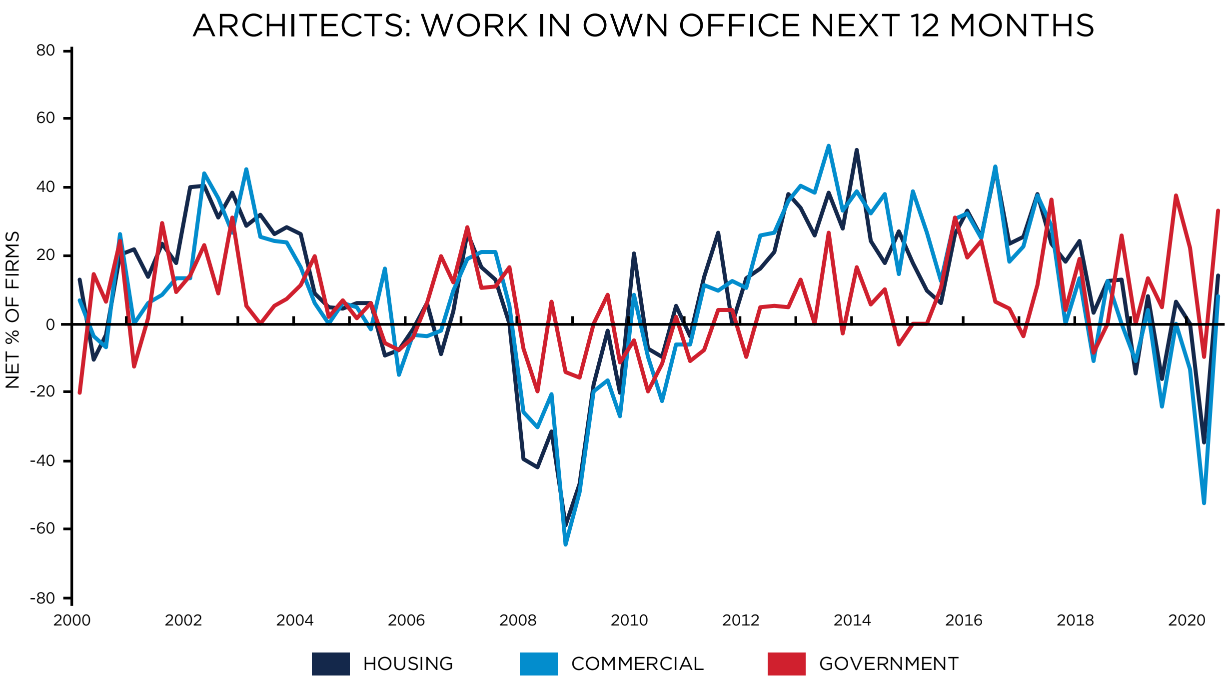


Source: RBNZ

FIGURE 4

Increased government spending on infrastructure

Net % of firms

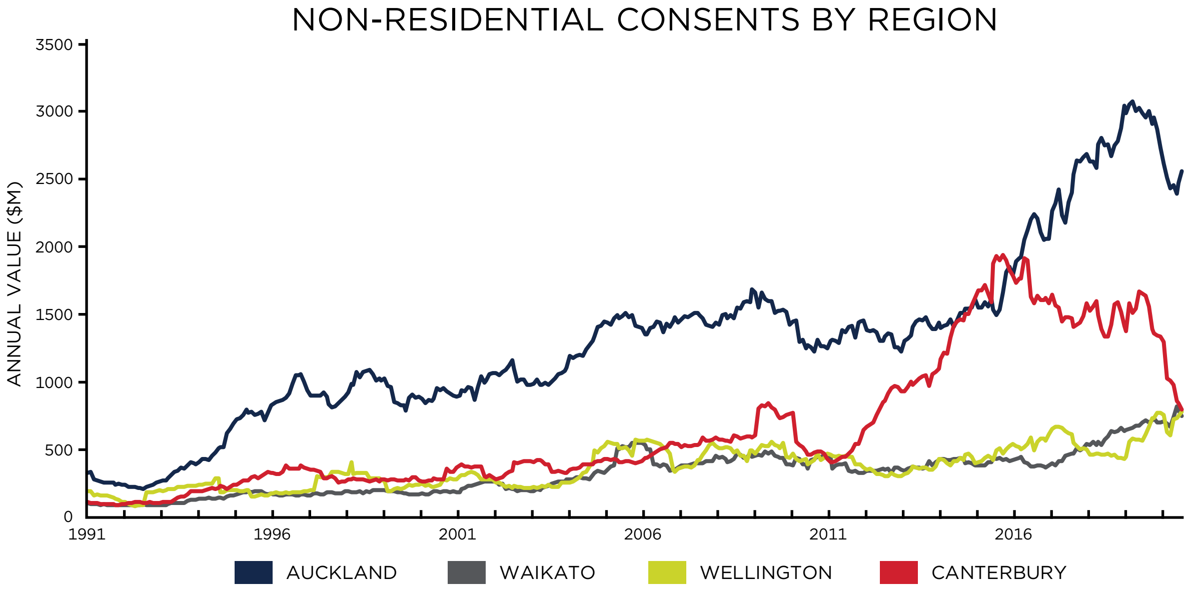


Source: NZIER

FIGURE 5

Continued caution amongst banks towards lending

Banks' observed change over the past 6 months

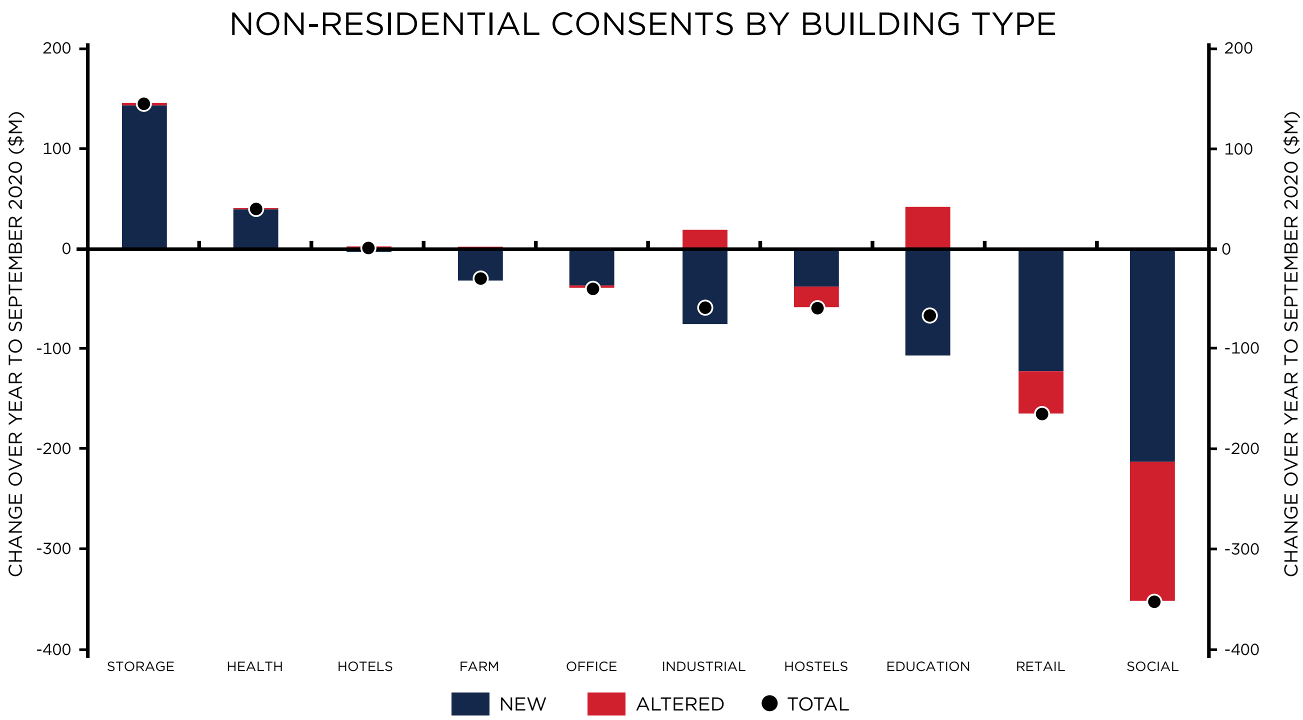


Source: Statistics NZ

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 September 2020; 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	3.8	25.4	70.9	16.7	18.6	18.4	13.7	13.6	17.8
AUCKLAND	124.1	234.8	183.2	372.3	139.4	349.2	392.6	487.4	252.0	25.0
WAIKATO	160.4	5.5	32.5	117.2	23.8	76.9	48.1	97.3	85.4	99.7
BAY OF PLENTY	12.5	21.9	13.6	56.9	48.3	59.3	29.4	51.4	70.5	13.2
GISBORNE	0.2	0.4	3.0	12.1	7.5	13.2	3.8	2.6	6.3	3.2
HAWKE'S BAY	2.9	4.0	47.5	20.8	5.2	23.8	26.7	34.0	45.9	18.8
TARANAKI	1.0	0.2	1.6	19.2	3.9	8.9	17.0	7.4	15.4	11.9
MANAWATU-WANGANUI	9.3	4.6	15.4	50.7	25.4	19.4	21.0	76.1	19.1	14.7
WELLINGTON	0.5	6.5	56.4	75.1	181.5	49.7	282.3	71.7	53.0	8.1
NELSON	0.3	0.2	8.1	2.2	1.7	5.9	0.9	3.5	2.6	0.4
TASMAN	0.1	1.1	7.5	11.2	4.1	20.4	3.1	6.0	13.9	1.5
MARLBOROUGH	4.0	3.9	0.0	5.4	25.4	3.2	2.5	4.7	24.7	3.4
WEST COAST	0.0	1.0	0.3	0.7	1.4	6.0	4.4	1.1	2.4	3.5
CANTERBURY	3.7	58.4	98.0	122.3	123.6	86.0	58.3	135.3	76.8	31.4
OTAGO	7.3	149.6	44.7	95.8	27.5	71.4	37.8	37.8	30.2	19.4
SOUTHLAND	0.0	10.1	1.4	22.3	7.8	66.9	11.5	40.2	22.5	18.6

Source: Statistics NZ, NZIER

Christchurch Town Hall Conservation Project, Christchurch

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 Second 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 eased sharply in the June 2020 quarter, as a sharp decline in construction activity saw capacity pressures dissipate. With the pipeline of construction starting to rebuild, construction sector firms are starting to report a re-emergence in labour shortages. The inability to source workers given border restrictions from overseas may exacerbate these labour shortages.

Nonetheless, we expect that increased capacity in the sector will largely weigh on construction cost escalation over the coming year. From late 2021, we expect a pick-up in construction cost escalation as the acceleration in construction activity sees capacity pressures build up modestly in the sector. Recognising the higher than usual degree of uncertainty over forecasting in these times, we expect annual construction cost escalation to pick up gradually from a trough of 1.4 percent in March 2021 to around 3.2 percent by mid-2024.

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	1841	0.2	4.5
	SEPTEMBER	1847	0.3	2.7
	DECEMBER	1855	0.4	1.6
2021	MARCH	1863	0.5	1.4
	JUNE	1872	0.5	1.7
	SEPTEMBER	1883	0.6	1.9
	DECEMBER	1894	0.6	2.1
2022	MARCH	1905	0.6	2.3
	JUNE	1917	0.6	2.4
	SEPTEMBER	1929	0.6	2.5
	DECEMBER	1943	0.7	2.6
2023	MARCH	1957	0.7	2.7
	JUNE	1972	0.8	2.8
	SEPTEMBER	1987	0.8	3.0
	DECEMBER	2002	0.8	3.1
2024	MARCH	2018	0.8	3.1
	JUNE	2034	0.8	3.2
	SEPTEMBER	2050	0.8	3.2
	DECEMBER	2066	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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