FIRST QUARTER 2019

FORECAST REPORT 90

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 90

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 continues to trend up

Residential construction lifted modestly in the September quarter. Although non-residential construction was flat over the quarter, the trend is one of increasing construction activity, after a plateau in early 2018. Underlying demand for construction is robust, particularly for residential construction.

Further slowing in net migration

A further slowing in net migration is driving easing population growth in New Zealand, with annual net inflows coming into the country edging below 62,000 for the first time since September 2015. Improving job prospects across the Tasman is supporting further net outflows to Australia.

Non-residential construction demand picking up in Waikato

Non-residential construction demand remains high in Auckland and is picking up in Waikato. Stronger demand for retail outlets and industrial buildings is supporting Auckland non-residential construction demand.

Interest rates on hold until at least early 2020

Soft economic data, including September quarter GDP, and increased bank capital requirements which will likely increase funding costs for banks, have renewed speculation the Reserve Bank will cut the Official Cash Rate (OCR) over the coming year. We continue to expect the Reserve Bank will keep the OCR on hold until at least early 2020.

The Crossing, Christchurch

BUILDING ACTIVITY TRENDS

Construction activity continued to trend higher the September 2018 quarter, with a modest lift in residential construction. Although non-residential construction was flat over the quarter, this followed a modest increase in the previous quarter. Positive factors continue to support construction activity, particularly demand for residential construction being underpinned by strong population growth in recent years.

The increase in construction activity follows a plateau in early 2018 as capacity and financing constraints limited growth. Underlying construction demand remains robust, with particularly strong growth in Auckland. Demand in Auckland is strong across both residential and non-residential construction, reflecting the effects of the surge in the region's population over the past few years.

Meanwhile, construction in Canterbury is stabilising after declining since 2016. Over the past year, increased demand for social buildings and retail outlets is offsetting reduced office building construction. Nonetheless, construction activity in the Canterbury region remains relatively high.

Population growth is easing on the back of a further slowing in net migration. Net annual inflows edged below 62,000 for the first time since September 2015. This partly reflected continued net outflows to Australia, as improved job prospects across the Tasman encourage New Zealand citizens to move to Australia and discourage them from returning. We expect this trend to continue over the coming year as the Australian labour market continues to improve.

More broadly, the number of people leaving New Zealand is picking up while the number of people coming into the country is falling. The latter reflected a decline in the number of non-New Zealand citizens moving here from other countries. A tightening up of immigration policy by the Government has been a key influence on this decline.

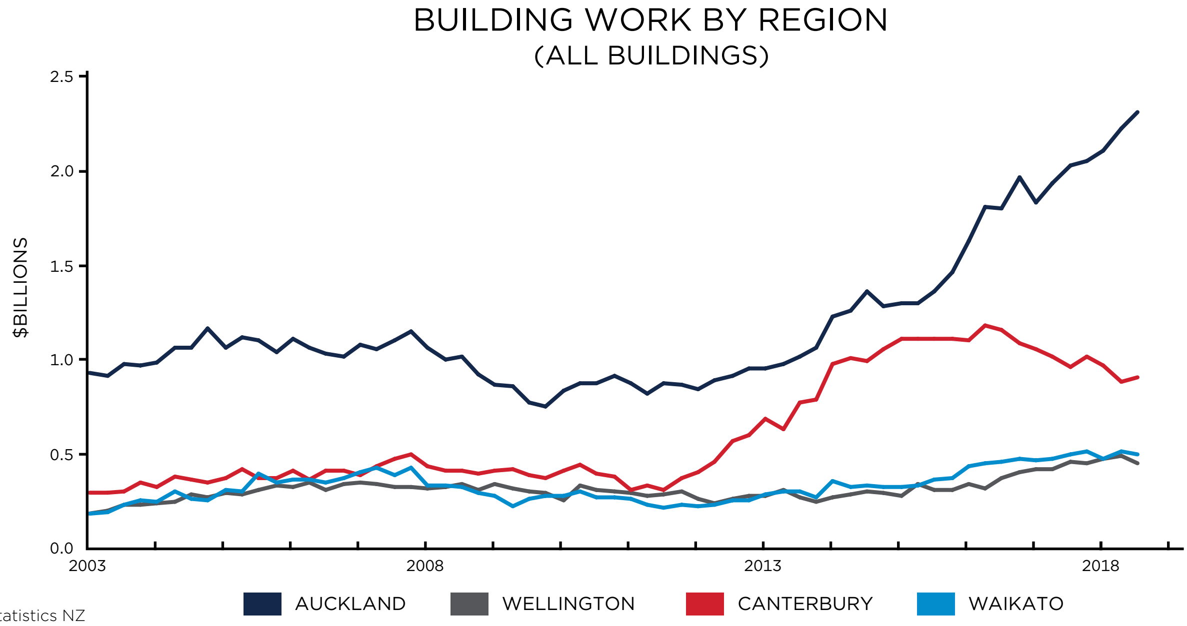
However, the decline in the number of people moving to New Zealand has been driven by reduced numbers coming in on residency and student visas. In contrast, the number of people moving to New Zealand on work visas continues to lift, with growth concentrated in trades workers. These workers from overseas have helped to alleviate some labour shortages in the construction sector over 2018, although the NZIER Quarterly Survey of Business Opinion (QSBO) indicates constraints for both skilled and unskilled workers remain acute.

We expect the Government will continue to focus on bringing in more trades workers over the coming year given the substantial amount of construction activity still to take place to meet housing demand. This should support continued population growth (albeit slowing) and see a further easing in construction sector labour shortages.

FIGURE 1

Construction demand led by Auckland

Value per quarter, s.a.



Source: Statistics NZ

BUILDING ACTIVITY OUTLOOK

BUILDING ACTIVITY OUTLOOK

Construction activity is picking up after a plateau over early 2018, and the pipeline of residential and commercial construction is growing. The flattening off in activity earlier in 2018 reflected uncertainty about the feasibility of some developments considering financing constraints. Banks have tightened up on access to credit, and increased capital requirements for banks mean there is likely to be further tightening over the coming years.

However, underlying demand for construction is robust. In particular, the surge in population since 2013 has driven strong housing demand, with higher house prices in recent years encouraging new residential construction. There continues to be a shift towards intensification of housing, with growth in consent issuance concentrated in multi-unit dwellings such as apartments and townhouses. We expect this trend to continue over the coming years, although low operating margins, labour shortages and uncertainty of cashflow faced by construction sector firms present headwinds to large-scale developments.

The NZIER QSBO shows architects expect an increase in the pipeline of residential and non-residential construction work over the coming year. In contrast, there is more caution about the pipeline of Government construction work. This likely reflects the change in the new Government's spending priorities, but we expect a recovery over the next few years as the Government invests in the construction, maintenance and remediation of education buildings and healthcare facilities.

ECONOMIC BACKDROP

Businesses remain downbeat in the face of weak profitability. Business confidence fell sharply in the wake of the new Labour-led Government taking office, reflecting uncertainty over Government policy changes and concerns over its impact on costs. These factors are having a particularly negative impact on businesses' appetite to invest in buildings.

Global developments present downside risks to the growth outlook. Unresolved trade tensions between the US and China are raising concerns about the implications for global growth. In particular, slowing Chinese growth has the potential to impact negatively on New Zealand export demand. The US Federal Reserve has pared back rate increase expectations for the coming year in light of heightened concerns about the growth outlook.

INTEREST AND EXCHANGE RATES

Headline inflation remains contained and within the 1 to 3 percent inflation target band. Petrol prices have been volatile, with higher global oil prices and excise taxes pushing petrol prices at the pump higher over the past year. Meanwhile, housing-related prices such as construction and rents remain robust. Outside of these areas, core underlying inflation is contained. Competitive pressures in the retail sector is limiting the extent to which retailers can raise prices, despite rising costs pressures.

We continue to expect underlying inflation to firm over the coming years as capacity pressures in the economy broaden beyond housing.

The US Federal Reserve have become more cautious about the US growth outlook, and have pared back expectations of interest rate increases as a result. Lower interest rate expectations for the US has weighed on its currency and underpinned a rebound in the NZD/USD.

Here in NZ, there has been renewed speculation the Reserve Bank will cut interest rates over the coming year. Increased capital requirements which will likely raise bank funding costs and see banks tighten access to credit, as well as softer September quarter GDP data, has increased expectations that the NZ economy may require further stimulus to support economic growth.

BUILDING INVESTMENT

The NZIER QSBO architects' measure of own activity points to a solid pipeline of residential construction work. The outlook for commercial construction also remains positive despite caution amongst businesses toward new investment in buildings. Meanwhile, uncertainty over the Government's changing priorities around infrastructure spending is weighing on the pipeline of Government construction work.

BUILDING CONSENTS

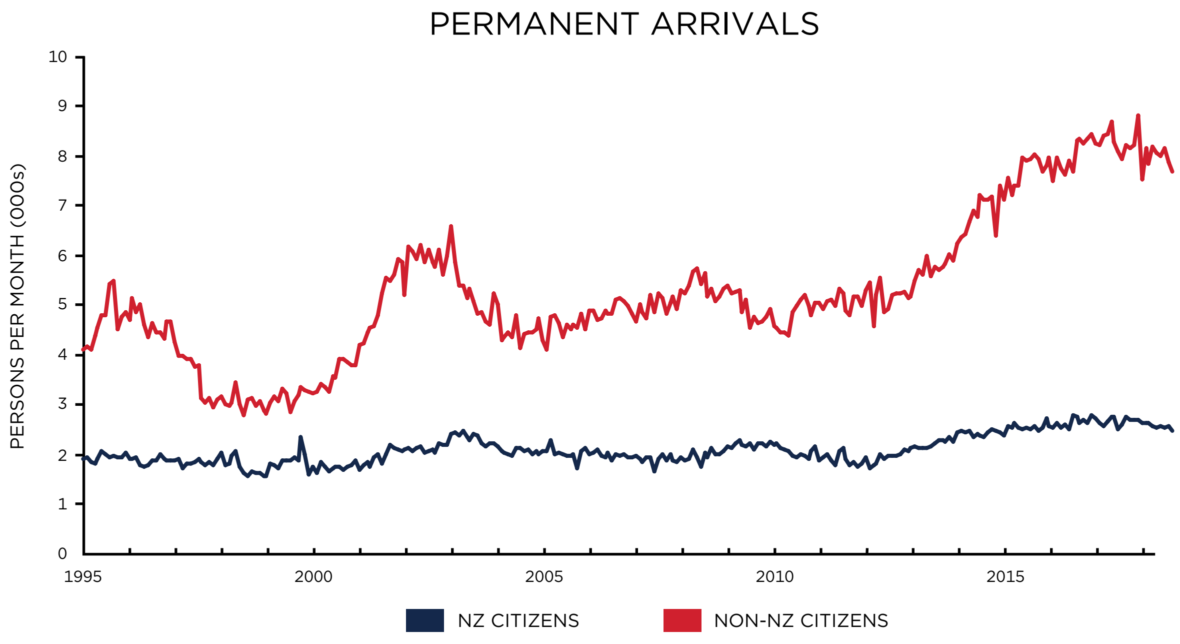
Demand for new retail outlets and social buildings were the top drivers of growth in non-residential construction over the past year. Demand for these sectors of non-residential construction was particularly strong in Auckland. However, Auckland also drove a sharp drop in demand for new office buildings, albeit from high levels in the previous year.

There was also an increase in demand for industrial, farm and storage buildings, reflecting improving demand in Waikato. Increasing confidence about profitability in the rural sector is underpinning this increased demand.

FIGURE 2

Less people moving to New Zealand from other countries

Number of people per month, s.a.



Source: Statistics NZ

The Terrace, Wellington

Building consents by sector

Recent jitters over trade tensions between the US and China, and the downside risks this presents to the global growth outlook and in turn export demand, may curtail further growth in demand for the construction of storage, industrial and farm buildings.

Continued uncertainty over the availability and willingness of major construction firms willing to lead the construction of large-scale vertical construction will likely limit growth in consent issuance for office buildings over 2019. Issues remain over who should bear the risks of construction cost overruns. Fletcher Building's recent exit from the bidding of vertical construction work may see a reshape of the incumbent model where the lead contractor has accepted the bulk of the risks of cost overruns on fixed price contracts.

However, population growth (while moderating) and tourism demand should underpin improved demand beyond 2019:

- 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 and redevelopment activity should also continue to contribute to non-residential construction demand.

Building consents by region

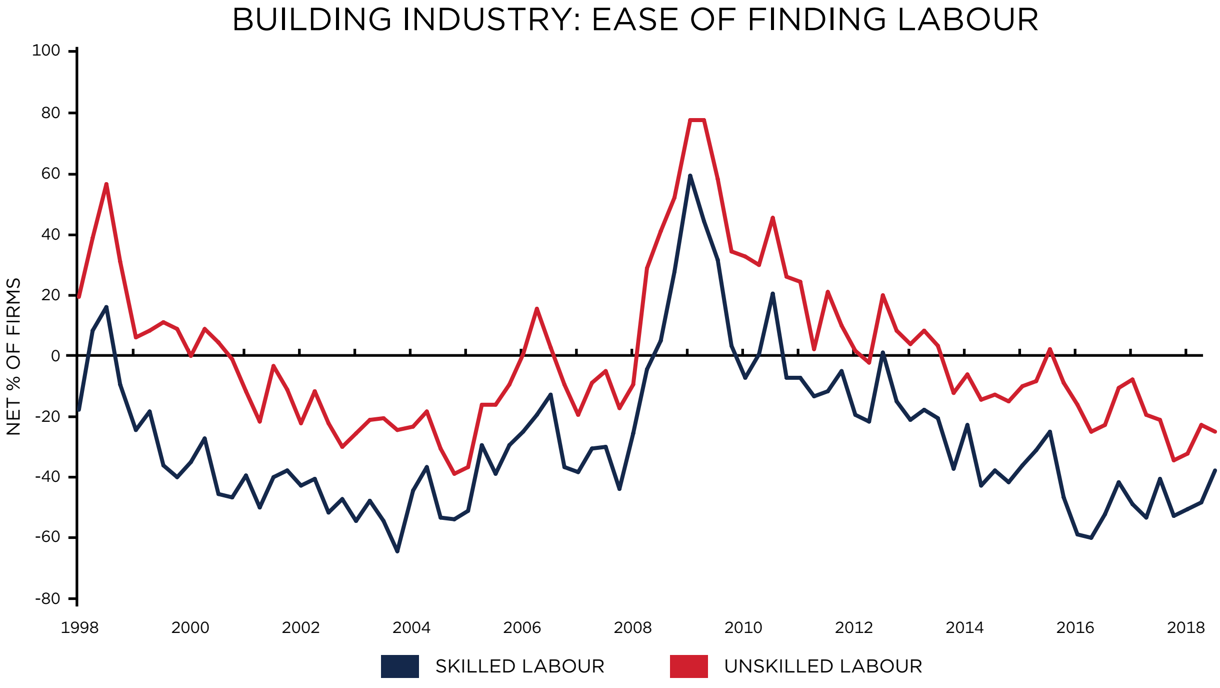
Growth in non-residential construction over the past year was strongest in Auckland, Waikato and Canterbury. The rebound in non-residential construction in Canterbury was largely driven by stronger demand for education and social buildings.

Given the concentration of strong population growth in Auckland in recent years, we expect Auckland and its neighbouring regions will continue to lead demand for non-residential construction over the coming years.

FIGURE 3

Building sector labour shortages improving, but still acute

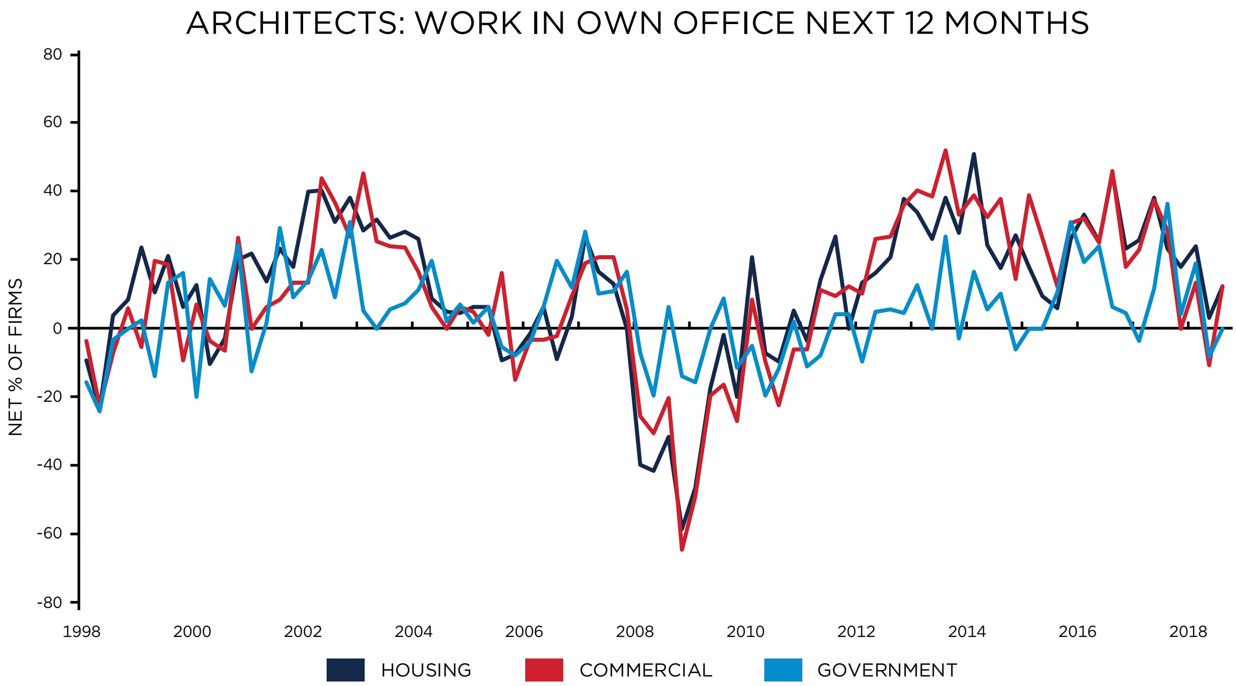
Net % of firms



Source: NZIER

FIGURE 4

Positive outlook for residential and commercial construction

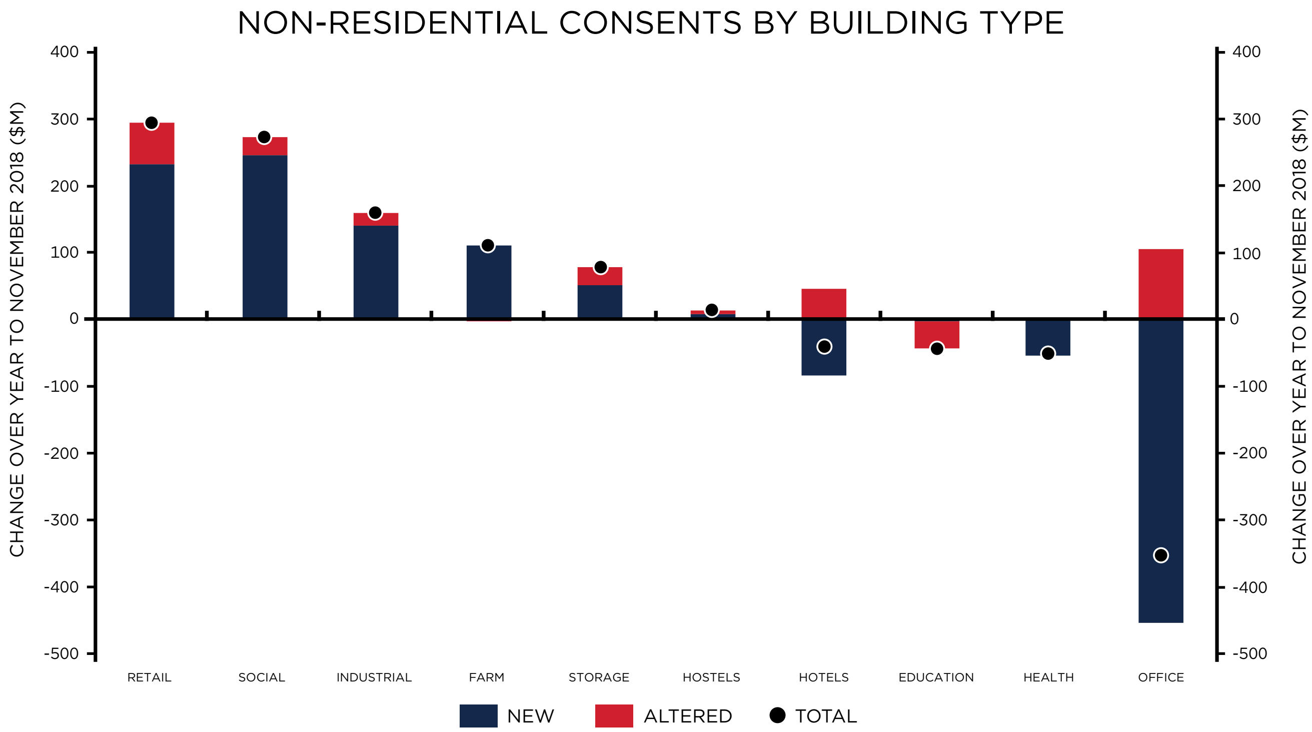


Source: Statistics NZ, NZIER

FIGURE 5

Retail demand remains top driver of growth in non-residential construction demand

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

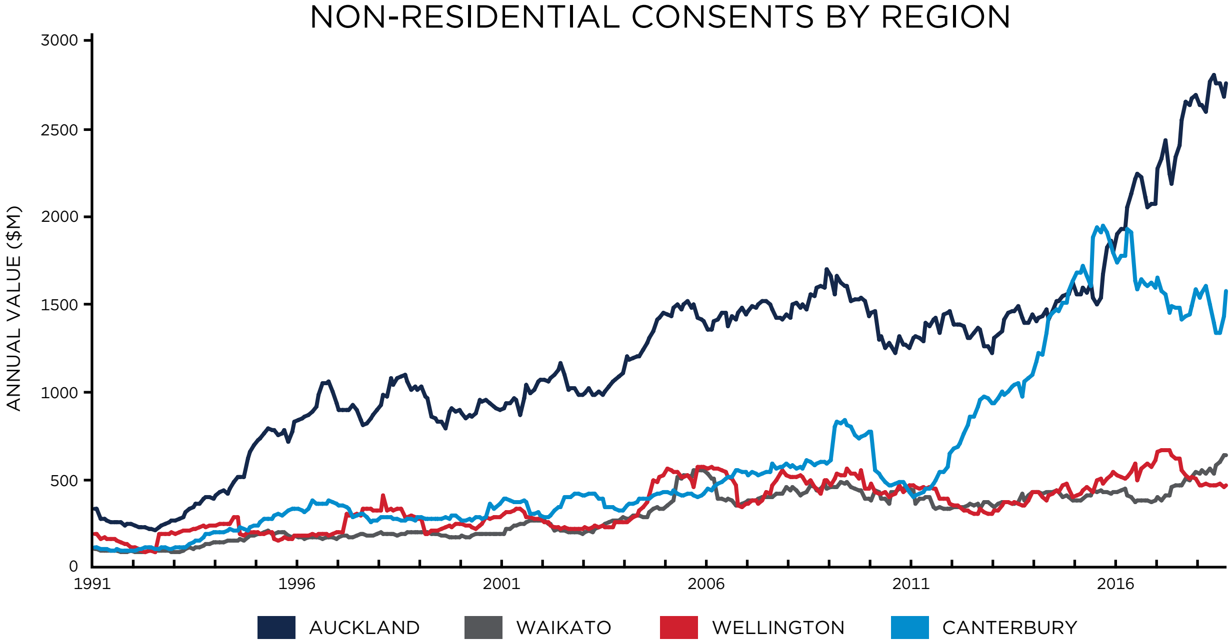


Source: Statistics NZ, NZIER

FIGURE 6

Construction growth continues to be led by Auckland and its neighbouring regions

Annual value



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

	SECTOR									
REGION	HOSTELS, PRISONS ETC	ACCOMODATION	HEALTH	EDUCATION	SOCIAL, CULTURAL, RELIGIOUS	RETAIL	OFFICE	STORAGE	INDUSTRIAL	FARM
NORTHLAND	4.0	9.9	16.5	30.0	20.5	14.9	20.1	6.3	12.2	15.4
AUCKLAND	146.3	218.8	132.0	365.3	339.2	516.3	289.4	403.7	314.6	28.7
WAIKATO	15.6	19.8	54.7	50.6	71.1	58.8	57.8	63.1	120.2	121.6
BAY OF PLENTY	0.6	29.7	24.9	25.3	24.4	129.2	77.4	74.4	33.5	12.1
GISBORNE	0.0	1.0	0.0	2.5	4.4	1.6	1.8	1.5	2.5	1.9
HAWKE'S BAY	1.5	4.5	14.5	10.2	6.5	12.0	29.1	26.2	18.7	6.8
TARANAKI	0.0	1.4	2.8	18.1	3.9	17.2	32.7	16.0	21.3	21.2
MANAWATU-WANGANUI	3.9	1.3	14.5	48.0	10.7	8.8	20.7	27.2	30.8	16.5
WELLINGTON	0.2	23.4	21.0	75.5	70.7	45.9	155.5	24.2	42.2	7.9
NELSON	2.8	0.1	20.0	4.4	0.9	2.9	3.1	4.2	6.8	0.3
TASMAN	0.6	0.8	4.0	4.4	1.2	3.3	5.4	22.2	7.5	3.0
MARLBOROUGH	2.1	0.8	3.7	1.9	7.8	12.8	2.0	2.7	14.3	6.5
WEST COAST	0.0	5.0	1.0	1.3	2.8	1.9	1.4	1.6	3.3	4.9
CANTERBURY	22.7	35.3	120.6	363.3	275.1	204.3	191.5	155.8	117.6	89.4
OTAGO	6.1	74.3	22.0	44.7	17.5	52.6	26.2	22.2	36.4	26.8
SOUTHLAND	1.1	2.1	1.2	4.5	4.7	8.0	8.4	6.7	17.2	11.2

Source: Statistics NZ, NZIER


St Mary of The Angels, 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 First 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.

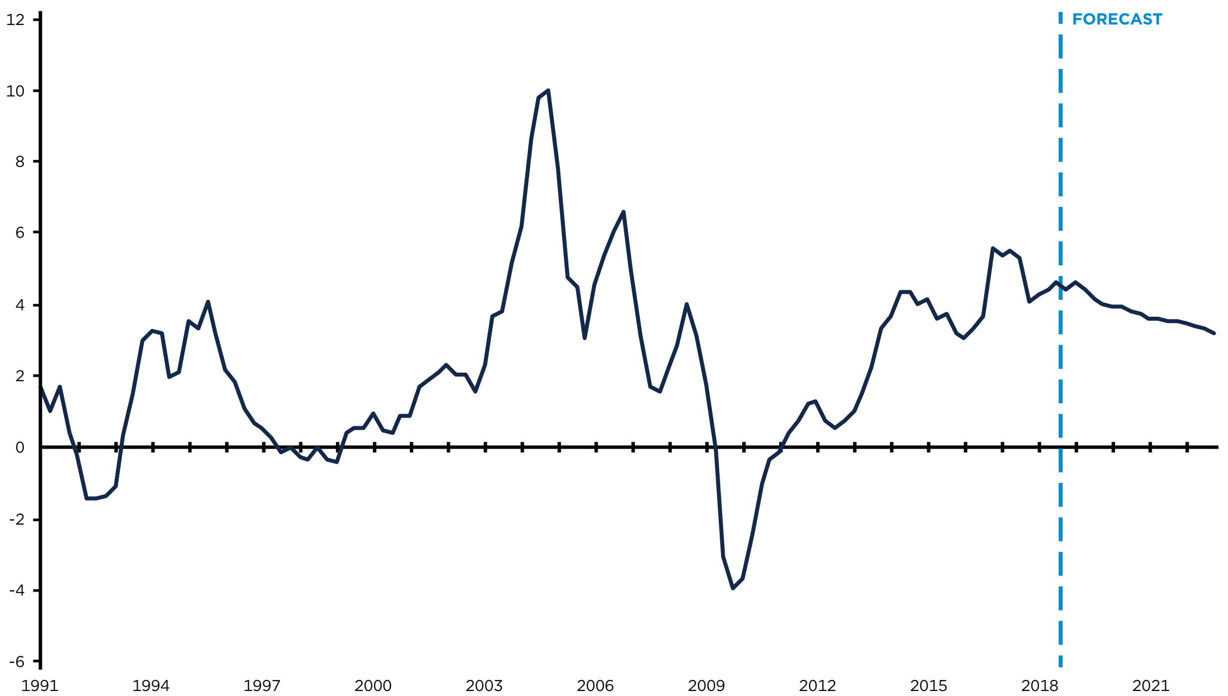
We continue to forecast construction cost inflation to lift to around 4.5 percent in mid- 2019 before moderating to 4 percent by the end of 2019. Beyond that, we expect annual construction cost inflation to ease to around 3.3 percent at the end of 2020, as capacity pressures in the construction sector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

This represents an extended period where construction cost inflation is elevated. Although capacity pressures in the construction sector remains acute, 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	0.4	1.0
	JUNE	1372	0.5	1.5
	SEPTEMBER	1384	0.9	2.2
	DECEMBER	1404	1.4	3.3
2014	MARCH	1415	0.8	3.7
	JUNE	1432	1.2	4.4
	SEPTEMBER	1444	0.8	4.3
	DECEMBER	1460	1.1	4.0
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
	SEPT	1711	1.3	4.6
	DEC	1730	1.1	4.4
2019	MARCH	1747	1.0	4.6
	JUNE	1764	1.0	4.4
	SEPTEMBER	1781	1.0	4.1
	DECEMBER	1799	1.0	4.0
2020	MARCH	1816	0.9	4.0
	JUNE	1833	0.9	3.9
	SEPTEMBER	1849	0.9	3.8
	DECEMBER	1866	0.9	3.7
2021	MARCH	1882	0.9	3.6
	JUNE	1899	0.9	3.6
	SEPTEMBER	1915	0.9	3.5
	DECEMBER	1932	0.9	3.5
2022	MARCH	1948	0.8	3.5
	JUNE	1964	0.8	3.4
	SEPTEMBER	1979	0.8	3.4
	DECEMBER	1994	0.7	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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