FORECAST REPORT 83

NEW ZEALAND TRENDS IN PROPERTY AND CONSTRUCTION

SECOND QUARTER 2017

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Cover: Mt Eden Prison Redevelopment, Auckland

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.

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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 83

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

SIGNS OF SOFTENING IN CONSTRUCTION DEMAND IN THE NEAR TERM

There are some signs of a softening in the construction pipeline in the near term, as higher construction and funding costs have seen some construction work put on hold.

BUT CONTINUED STRONG NET MIGRATION SHOULD UNDERPIN DEMAND IN LONG RUN

However, with net migration showing little sign of abating we expect underlying demand for both residential and non-residential construction to remain robust over the coming years.

STRONG TOURISM ACTIVITY BOOSTS DEMAND FOR ACCOMMODATION

With a continued high number of tourist inflows placing capacity pressures on the tourism sector, demand for accommodation buildings is lifting.

INTEREST RATES LIKELY ON HOLD OVER 2017

The Reserve Bank has indicated it does not expect to have to cut interest rates further during this cycle. Although inflation is lifting, heightened offshore risks suggest there is no urgency for the Reserve Bank to lift interest rates. We expect the Reserve Bank to keep the OCR on hold until mid-2018.

BUILDING ACTIVITY TRENDS

The underlying drivers of construction remain strong, with a continued surge in net migration boosting demand for new dwellings and commercial buildings. Annual net migration edged up to over 71,000 for the year to January 2017. The number of residents leaving New Zealand remains very low, while there remains strong growth in the number of people moving to New Zealand. Net migration in Auckland remains particularly strong, and this continues to underpin strong housing demand in the region.

Besides supporting demand across many sectors including construction, the increased number of permanent migrants has also expanded the labour supply. The ramp-up in construction activity in recent years has placed capacity pressures on the construction sector, with building sector firms in the latest NZIER Quarterly Survey of Business Opinion reporting labour shortages at its most acute since 2004. However, there has been an improvement in the availability of labour in recent quarters. Over the past year, growth in work visas in the trades have been particularly strong, as migrants help to mitigate labour shortages in the construction sector.

Nonetheless, construction costs have increased sharply over the past year, with the acceleration particularly evident in Auckland where capacity pressures in the region's building sector are more acute. Higher construction costs, along with reduced availability in credit, have seen some construction projects put on hold. There has been a softening in consent issuance for houses, apartments and retirement villages in recent months.

The architects' measure of residential and commercial work in their own office in the latest NZIER Quarterly Survey of Business Opinion also suggest some easing in growth in the pipeline of construction work over the remainder of 2017.

Beyond the softening in construction demand in the near term, we expect migration-led population growth will underpin strong underlying demand for residential construction over the coming years. For example, net migration into Auckland totalled around 33,000 over the past year, suggesting around 11,000 new dwellings would need to be built in the region just to keep up with net migration. The circa-10,000 dwellings consents issued in Auckland over the past year falls short of this.

Three things, either alone or in combination, would need to happen to reverse the current long-term drivers of building activity.

The first would be a large reduction in visas issued by the New Zealand government for permanent and long-term migrants. While an election year does carry the risks of populist policies, we note that unlike in the US and much of Europe, the New Zealand economy continues to grow strongly.

Second would be an unexpected upswing in the Australia economy, enticing kiwis back over the ditch. Our forecasts of trade partner growth do not see this as likely.

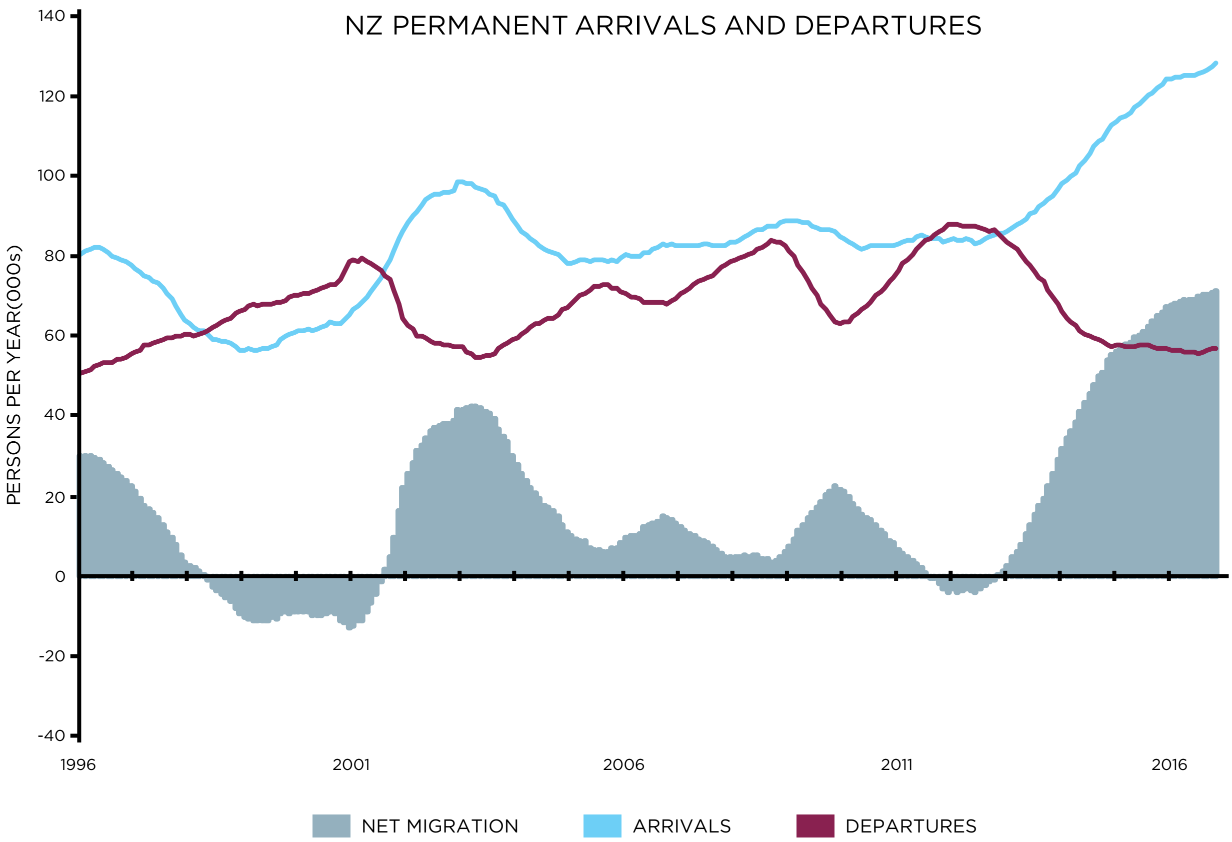
Finally, tourism numbers would have to fall from their historic highs. Again, the underlying drivers of growth – bigger, more fuel efficient planes; rising middle classes in Asia and New Zealand comparative safety as a tourism destination – are all pointing to continued growth.

Non-residential demand continued to ease in recent months, reflecting weaker demand for commercial buildings despite high levels of business confidence. Partly offsetting this decline has been stronger demand for accommodation buildings, as construction finally responds to the capacity pressures in the tourism sector in the face of continued high numbers of tourist inflows.

FIGURE 1

NZ CONTINUES TO ATTRACT A LARGE NUMBER OF MIGRANTS

PERMANENT ARRIVALS AND DEPARTURES, ANNUAL 000s



Source: Statistics NZ, NZIER

BUILDING ACTIVITY OUTLOOK

ECONOMIC BACKDROP

The domestic outlook continues to look very robust, but against a backdrop of increasing global risks. Construction and tourism remain key drivers of growth in the New Zealand economy with activity broadening beyond Auckland, while the continued recovery in global dairy prices is also underpinning improved confidence in the rural regions.

Although some cities directly affected by the earthquakes such as Kaikoura are still rebuilding, the effects have largely been contained. A strong Government balance sheet will comfortably absorb the costs of damage, with room still left for sweeteners heading into election year.

INTEREST AND EXCHANGE RATES

Underlying inflation is lifting, reflecting capacity pressures in some sectors such as construction. As expected, annual inflation edged back within the Reserve Bank's 1 to 3 percent target in the December 2016 quarter – the first time since September 2014 inflation is back in the target band. We expect that as capacity pressures broaden across the sectors, inflation will continue to rise and edge close to the Reserve Bank's inflation target mid-point of 2 percent later this year. Nonetheless, heightened offshore risks mean the Reserve Bank will not be in any hurry to lift interest rates. We expect the Reserve Bank will keep the OCR on hold at 1.75% until mid-2018.

The New Zealand dollar has been volatile in recent months, with a softer than expected Q4 NZ GDP result placing some downward pressure on the currency. We expect the New Zealand dollar to ease over the coming years as the other major economies start to improve, and the US Federal Reserve tightens at a faster rate than New Zealand.

BUILDING INVESTMENT

Building Work Put in Place shows modest growth in non-residential construction over the December quarter. Although indicators such as the NZIER Quarterly Survey of Business Opinion architects' measure of own activity show some softening in growth in the pipeline of non-residential work for the coming months, strong population growth and tourism activity should remain a key support for demand for new offices and hotels over the next few years.

BUILDING CONSENTS

Non-residential building consent issuance continued to ease in recent months, reflecting softer demand for new office buildings and retail outlets. This is despite prime office vacancy remaining at historically low levels, particularly in Auckland.

The average value per square metre consented has continued to lift sharply. Although this measure is very volatile, the continued strong upward trend suggests an acceleration in construction cost inflation.

BUILDING CONSENTS BY SECTOR

The continued surge in tourist inflows has seen accommodation buildings lead the way in non-residential construction demand, as supply responds to growing capacity pressures in the tourism sector. Growth in non-residential construction demand over the past year was strongest for hotels, with healthcare facilities and hostels rounding out the top three drivers of non-residential construction growth as the population continues to expand.

There has been a substantial decline in demand for office buildings over the past year, reflecting lower issuance of consents for both new office buildings as well as alterations. The decline in office consent issuance has been particularly sharp in Canterbury. In addition, with banks continuing to tighten access to credit in recent months this is likely to weigh on demand for new office developments.

Earthquake rebuilding and strengthening activity will add to non-residential construction demand over the next year.

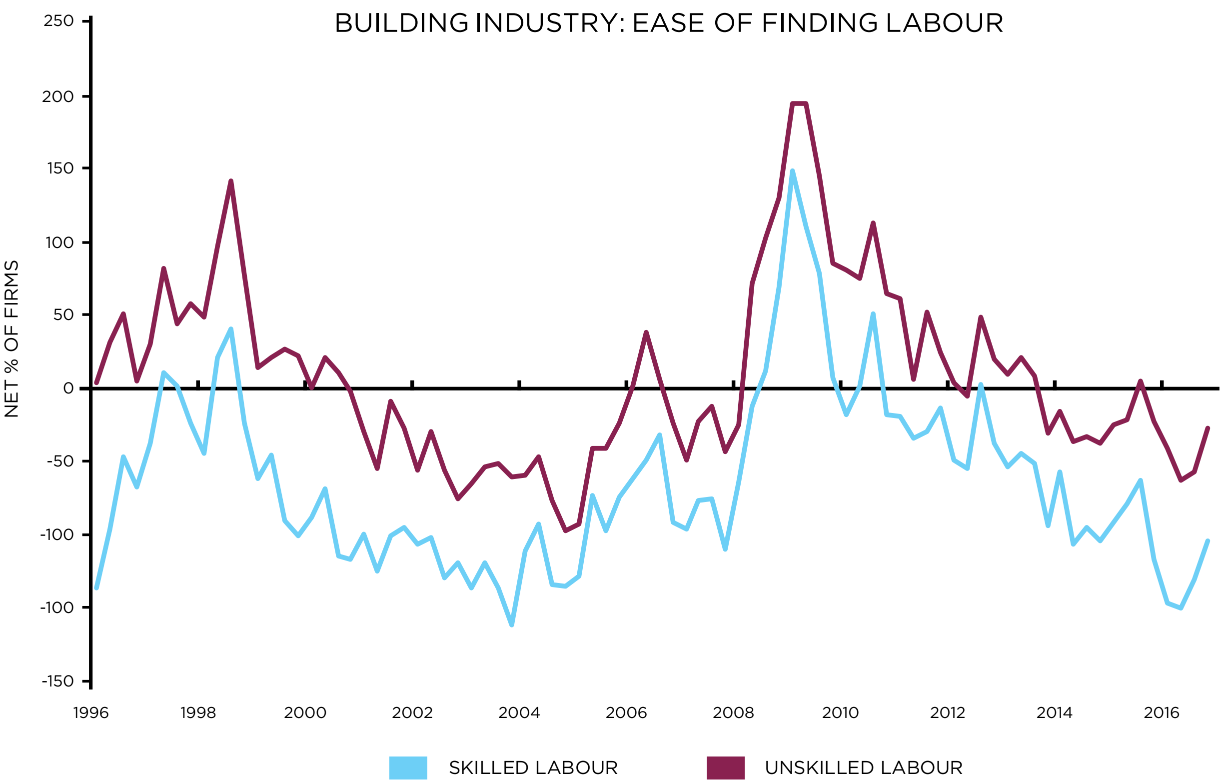
Strong population growth underpin many of the longer-term trends:

- Office growth to accommodate the higher number of workers.
- Public sector spending on education and healthcare facilities, along with rebuilding activity.
- Capacity constraints in the tourism sector will continue to drive demand for new accommodation buildings.

FIGURE 2

BUILDING SECTOR FIRMS REPORT AN EASING IN LABOUR SHORTAGES

NET % OF FIRMS REPORTING EASE IN FINDING LABOUR



Source: Statistics NZ, NZIER

Geyser Commercial Building, Auckland

BUILDING CONSENTS BY REGION

Construction demand continues to grow strongly in Auckland and its neighbouring regions of Waikato and the Bay of Plenty, reflecting the effects of relatively strong population growth in these regions. In particular, strong population growth is boosting demand for healthcare and education facilities in Auckland. Despite the decline in consent issuance for new office buildings nationwide, demand in Auckland continues to grow over the past year. Construction demand in Waikato and the Bay of Plenty is largely for housing.

Meanwhile, construction demand is also lifting in Wellington, reflecting increased demand for office buildings and retail outlets.

In contrast, Canterbury continues to face reduced construction demand. Consent issuance for education and office buildings have fallen sharply over the past year, as post-earthquake rebuilding activity tapers off.

Nonetheless, we still expect construction activity to remain at a high level over the coming year given the amount of rebuilding activity that still needs to take place.

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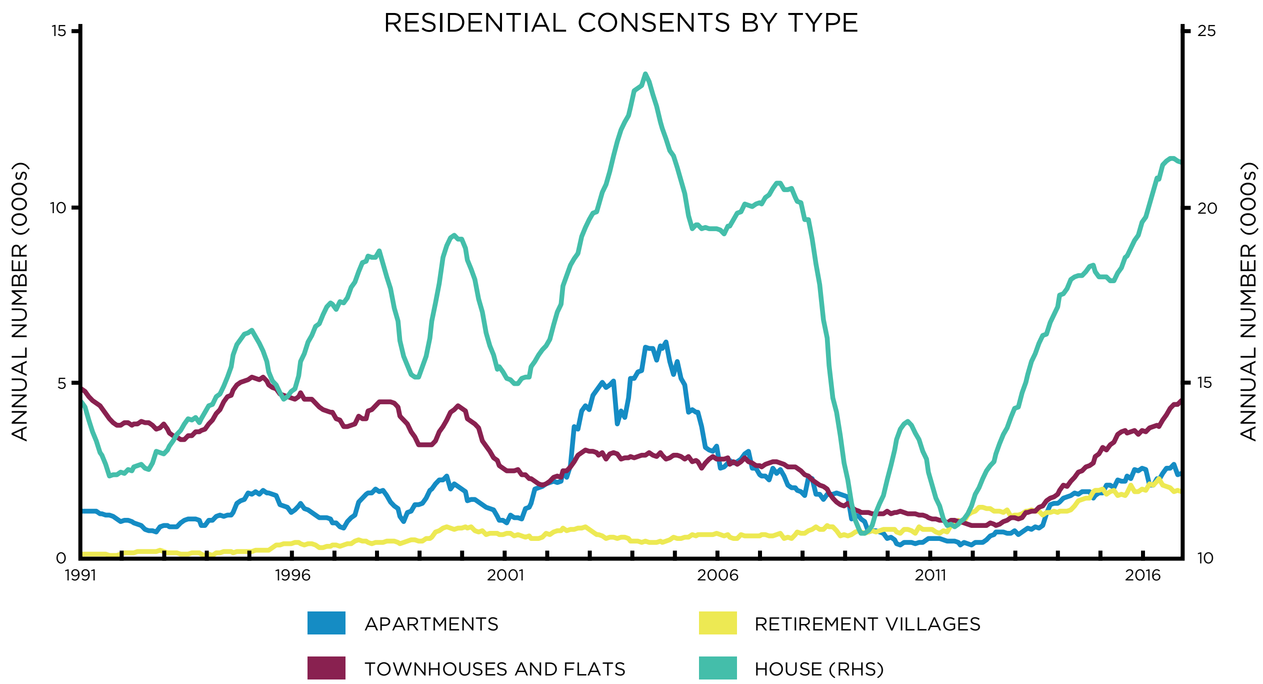
FIGURE 3

SOFTENING IN CONSENT ISSUANCE FOR HOUSES AND APARTMENTS

ANNUAL CONSENTS, NUMBER 000s



Source: Statistics NZ, NZIER

FIGURE 4

CONSTRUCTION COSTS CONTINUE TO RISE WHILE CONSENT ISSUANCE EASES

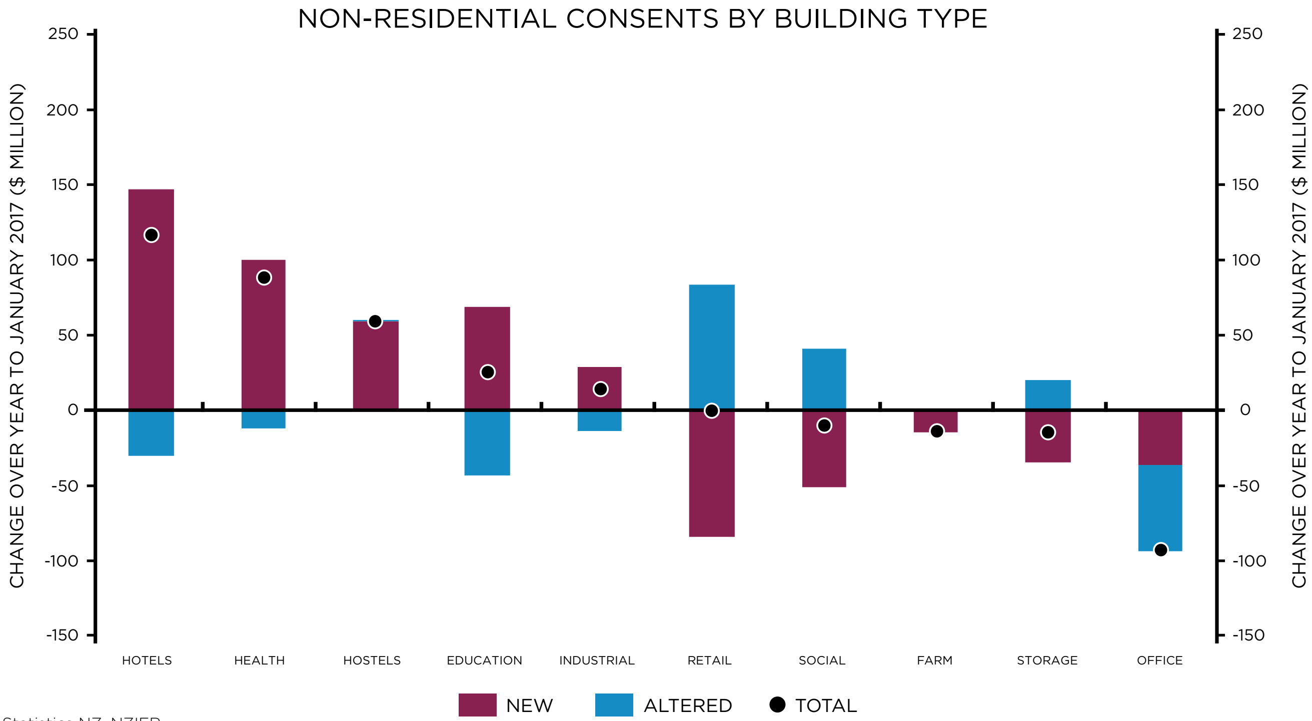
NON-RESIDENTIAL CONSENT ISSUANCE AND VALUE PER SQUARE METRE

Source: Statistics NZ, NZIER

FIGURE 5

STRONG TOURISM ACTIVITY BOOST DEMAND FOR ACCOMMODATION BUILDINGS

ANNUAL CHANGE IN CONSENTS, $M, YEAR ENDED JANUARY 2017

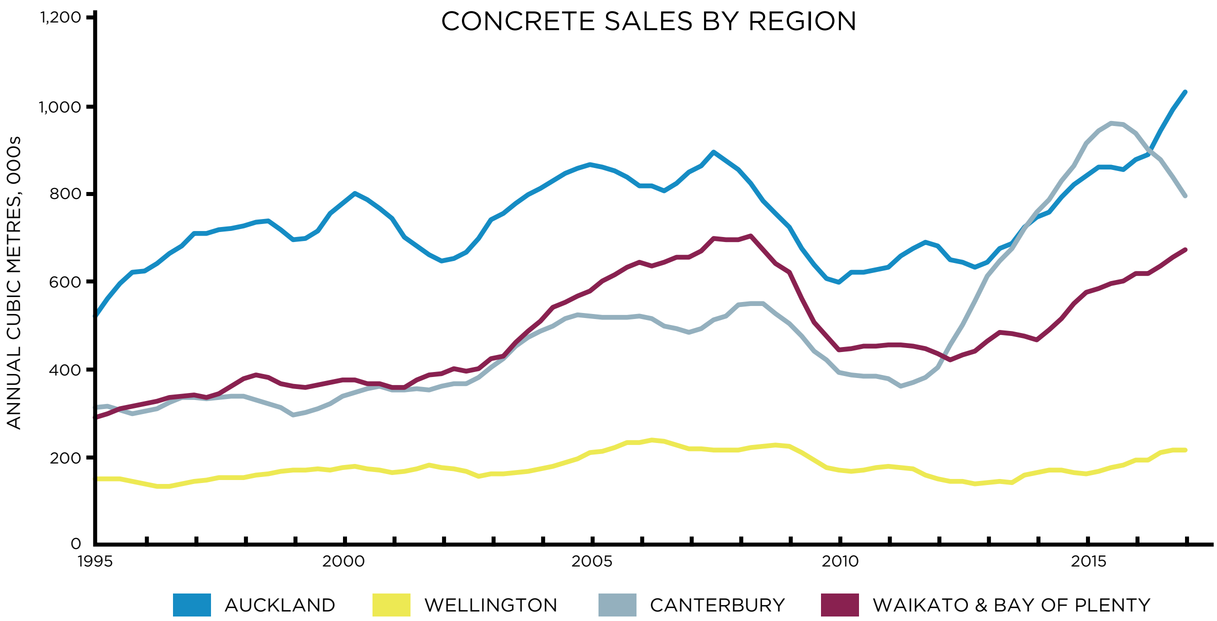


Source: Statistics NZ, NZIER

FIGURE 6

CONSTRUCTION GROWTH CONTINUES TO BE LED BY AUCKLAND

ANNUAL VOLUME, THOUSAND CUBIC METRES



Source: Statistics NZ

TABLE 1

NON-RESIDENTIAL BUILDING CONSENTS BY REGION AND SECTOR

$M OF CONSENTS FOR THE YEAR ENDING JANUARY 2017; 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	2.5	4.1	19.6	2.8	8.1	9.4	3.5	4.5	7.7
AUCKLAND	151.4	83.0	202.4	415.0	80.3	284.8	484.9	229.1	101.9	30.5
WAIKATO	0.7	7.6	38.9	41.9	29.4	57.8	29.6	40.6	63.9	57.8
BAY OF PLENTY	1.5	0.5	19.6	43.0	30.9	30.5	57.4	72.5	24.5	9.9
GISBORNE	0.0	0.0	1.1	1.7	2.8	1.6	9.9	0.7	10.9	1.8
HAWKE'S BAY	7.6	0.2	4.5	17.4	13.7	18.3	16.7	18.5	33.0	6.7
TARANAKI	0.7	4.8	4.7	14.8	11.8	6.8	14.2	2.6	31.3	24.4
MANAWATU-WANGANUI	6.0	3.9	13.6	21.6	9.9	15.4	32.9	5.9	17.3	16.2
WELLINGTON	12.6	32.5	18.7	69.3	45.7	89.8	323.9	22.9	36.0	5.3
NELSON	0.0	0.0	3.2	7.5	9.3	6.9	2.1	12.3	6.8	0.6
TASMAN	0.0	0.4	0.1	3.8	3.6	6.5	2.5	7.6	4.3	4.2
MARLBOROUGH	0.0	2.0	0.2	6.1	4.8	1.3	8.5	4.1	11.7	4.6
WEST COAST	0.0	4.3	55.7	1.4	1.8	0.8	1.8	0.7	0.7	1.9
CANTERBURY	21.5	93.1	258.4	316.2	128.7	198.0	214.5	229.0	110.7	51.2
OTAGO	24.1	34.2	4.4	184.3	9.5	40.6	26.7	20.6	24.6	15.3
SOUTHLAND	5.2	0.8	1.7	5.5	1.5	11.5	6.6	14.5	15.8	9.0

Source: Statistics NZ, NZIER

ASB North Wharf, Auckland

BUILDING COSTS

The Capital Goods Price Index for Non-Residential Buildings (CGPI-NRB) provides an official measure of cost movements in the sector. The CGPI-NRB excludes GST. The rate of increase in the CGPI-NRB can be used as an indicator of cost escalation.

The CGPI-NRB is a national average across all regions and building types. We therefore advise caution in applying the increase in the CGPI-NRB as an indicator of cost escalation for specific building projects.

The Rider Levett Bucknall First Quarter 2017 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.

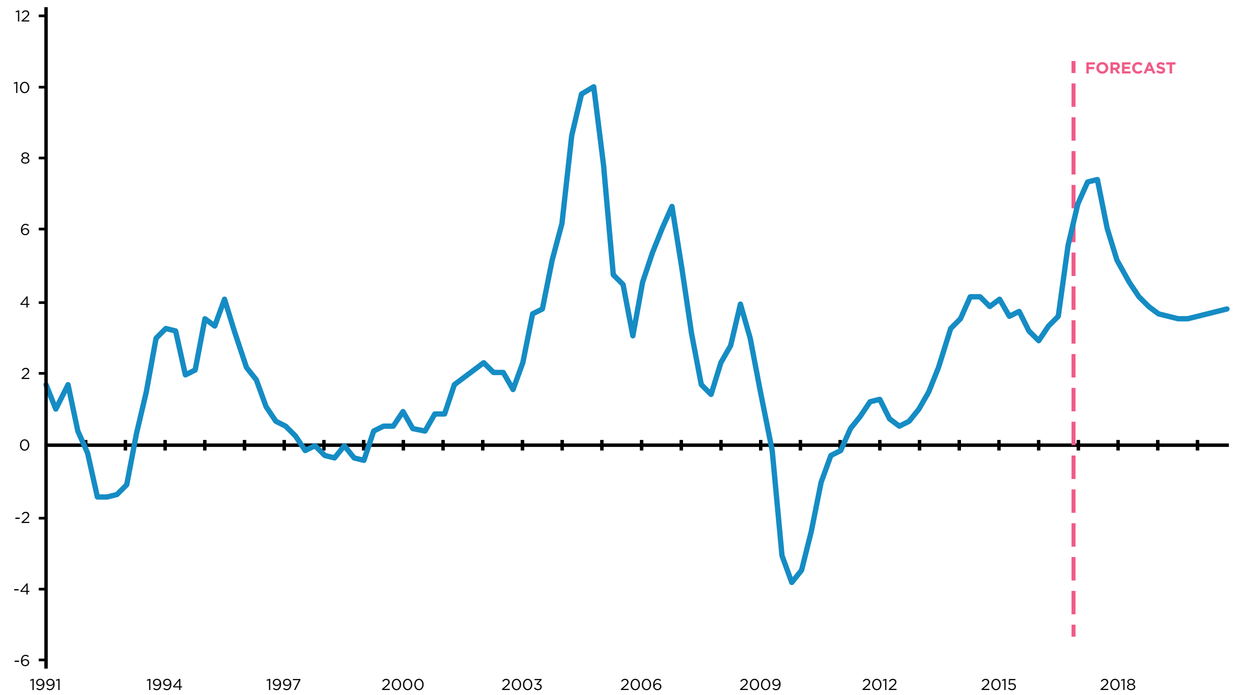
Construction costs increases have picked up more recently as construction activity continues to rise, but there are differences across the regions. While resource and capacity constraints have eased in Canterbury, they are more acute in Auckland.

NZIER forecasts construction cost inflation to edge up to over 7% in 2017, and to moderate to under 4% by the end of 2020. This represents the highest sustained inflation in the sector since the construction boom of the mid-2000s. However, NZIER does not expect the inflation to be as sharp as the mid-2000s given 1) the lower inflation environment limits the extent to which rising costs can be passed on quickly, and 2) strong net migration is helping to mitigate skills shortages in the building sector.

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
2011	MARCH	1334	0.1	-0.1
	JUNE	1342	0.6	0.4
	SEPT	1347	0.4	0.8
	DEC	1349	0.1	1.2
2012	MARCH	1351	0.1	1.3
	JUNE	1352	0.1	0.7
	SEPT	1354	0.1	0.5
	DEC	1358	0.3	0.7
2013	MARCH	1365	0.5	1.0
	JUNE	1372	0.5	1.5
	SEPT	1383	0.8	2.1
	DEC	1402	1.4	3.2
2014	MARCH	1413	0.8	3.5
	JUNE	1429	1.1	4.2
	SEPT	1440	0.8	4.1
	DEC	1456	1.1	3.9
2015	MARCH	1471	1.0	4.1
	JUNE	1480	0.6	3.6
	SEPT	1494	0.9	3.8
	DEC	1502	0.5	3.2
2016	MARCH	1514	0.8	2.9
	JUNE	1529	1.0	3.3
	SEPT	1548	1.2	3.6
	DEC	1586	2.5	5.6
2017	MARCH	1616	1.9	6.7
	JUNE	1641	1.6	7.3
	SEPT	1663	1.3	7.4
	DEC	1682	1.2	6.1
2018	MARCH	1700	1.0	5.2
	JUNE	1716	1.0	4.6
	SEPT	1732	0.9	4.2
	DEC	1747	0.9	3.9
2019	MARCH	1762	0.9	3.7
	JUNE	1778	0.9	3.6
	SEPT	1793	0.9	3.5
	DEC	1810	0.9	3.6
2020	MARCH	1826	0.9	3.6
	JUNE	1843	0.9	3.7
	SEPT	1861	0.9	3.8
	DEC	1878	0.9	3.8

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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